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CROSS OWNERSHIP OF FINANCIAL INSTITUTIONS
AND CORPORATIONS IN VIETNAM - AN ASSESSMENT
AND RECOMMENDATIONS

INTRODUCTION

As a wave preceding the trend of integration and growth, the Vietnamese financial system in general and its banking system in particular have been dramatically growing since the late 2006. Increases in the banks’ capital and assets are expected to facilitate the fierce competition within the frameworks of WTO and other investment and trade agreements. However, this poses a requirement for, and hence, a challenge of the banking governance and financial supervision.

To meet the requirement for international integration, the Vietnamese government promulgated Decree 141/2006/ND-CP dated 22/11/2006 on the legal capital requirements in financial institutions. However, Decree 141 has not required an enhancement of the banking management capacity accordingly. The bank monitoring framework has not been improved and still out of date until 2010, especially when the banking system has been rapidly changing and the demand for financial safety monitoring capacity has been increasing.

Since the late 2008, when the deadline of capital adequacy requirements was looming, many banks have created some tricks to meet the capital requirements of current regulations de jure but not de facto. The complex forms of cross ownership (CO) have been created for banks to avoid from monitoring by the State Bank of Vietnam (SBV). As noted by the authors, CO has its own strengths and weaknesses by nature, as proved by experiences from countries cited in the study. The implications of CO depend on the institutional environment and the quality of the monitoring system. The dominant state-ownership in the banking system, the expansion of the state-owned enterprises
Cross Ownership of Financial Institutions and Corporations in Vietnam

(SOEs) into the banking sector, and the cross ownership have allowed some interest groups to usurp the power while loopholes in the legal system make it hard to exert the effect of safe banking regulations; this is one of important reasons for high non-performing loans (NPLs). Based on the research findings, the authors point out some risks in the banking system currently and have several institutional recommendations to effectively take controls of CO in the coming time.

This study is developed in the framework of the UNDP-sponsored Project “Supporting the enhancement of consultation, appraisal and monitoring capacities of macroeconomic policies” by the Economic Commission of the National Assembly. All assertions, analyses, assessments, and data in the study reflect the authors’ point of view, and do not reflect the Economic Commission, the Project Management Unit, and UNDP’s.

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This study is implemented in the framework of the UNDP-sponsored Project “Supporting the enhancement of consultation, appraisal and monitoring capacities of macroeconomic policies” by the Economic Committee of National Assembly.
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ABBREVIATION

ALCO    Asset-liability committee
AMC     Asset Management Company
BCBS    Basel Committee on Banking Supervision
BSIA    Banking Supervision Inspection Agency
VSI     Vietnam Social Insurance
BOS     Board of Supervisors
MOF     Ministry of Finance
CAR     Capital Adequacy Ratio
CEO     Chief Executive Officer
SOE     State-owned enterprise
ECNA    Economic Committee of National Assembly
EO      Economic organization
Fed     U.S. Federal Reserve System
BOM     Board of Management
IPO     Initial public offering
LDR     Loan to deposit ratio
M&A     Merger and Acquisition
NFSC    National Financial Supervisory Committee
SBV     State Bank of Vietnam
CB      Commercial bank
JSC     Joint-stock company
JSCB    Joint-stock commercial bank
JSB     Joint-stock bank
JVB     Joint-venture bank
IJSC    Investment joint-stock company
SOCB    State-owned commercial bank
NIM     Net interest margin
OECD    Organization for Economic Co-operation and Development
OMO     Open Market Operations
ROA     Return on Assets
ROE     Return on Equity
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<th>Abbreviation</th>
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<td>SCIC</td>
<td>State Capital Investment Corporation</td>
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<td>CO</td>
<td>Cross ownership</td>
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<td>OO</td>
<td>Overlapping ownership</td>
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<td>FI</td>
<td>Financial Institution</td>
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<td>HCMC</td>
<td>Ho Chi Minh City</td>
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<td>SSC</td>
<td>State Securities Commission</td>
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<tr>
<td>PC</td>
<td>People’s Committee</td>
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<td>VAMC</td>
<td>Vietnam Asset Management Company</td>
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<td>VBSP</td>
<td>Vietnam Bank for Social Policies</td>
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<td>VDB</td>
<td>Vietnam Development Bank</td>
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<td>VNBA</td>
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<td>VND</td>
<td>Vietnamese dong</td>
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<td>WTO</td>
<td>World Trade Organization</td>
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<td>Southeast Asia JSCB</td>
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<td>Saigon Bank</td>
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<td>Viet A Bank</td>
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<td>JSCB for Foreign Trade of Vietnam</td>
<td>VCB</td>
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<td>VPBank</td>
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<td>Vietnam Thuong Tin JSCB</td>
<td>VTB</td>
<td>Vietbank</td>
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<td>PVComBank</td>
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Cross Ownership of Financial Institutions and Corporations in Vietnam

Ha Noi Housing JSCB*  xHBB  Habubank
De Nhat JSCB *  xFCB  Ficombank
Saigon JSCB*  xSCB  SCB
Vietnam Tin Nghia JSCB*  xTNB  Tin Nghia Bank

Note: * Banks have been restructured via trading, M&A.
CHAPTER 1

AN OVERVIEW AND THE RESEARCH SUBJECT

1.1. An overview of the Vietnamese banking system
1.1.1. The number and size have been growing but the quality is inadequate

Before 1990, there was only one category of banks in Vietnam – the state-owned banks including Bank for Investment and Development of Vietnam (BIDV)\(^1\), Vietnam Commercial Bank (Vietcombank)\(^2\), Bank for Agriculture and Rural Development (Agribank), and Bank for Industry and Trade (Vietinbank). The Ordinance of Banks issued in May 1990 allowed the establishment of banks owned by other sectors, comprising of joint-stock and joint-venture banks. Upon the new legal foundation, 4 joint-stock commercial banks (JSCBs) and a joint-venture commercial bank (JVCB) were formed in 1991. By 1993, the number of JSCBs increased to 41, by 10 times from that of two years ago, in addition to 2 JVCBs, and especially the advent of the 8 foreign bank branches for the first time in Vietnam. The number of JSCBs was continuously increasing, hit a peak of 56 before the financial crisis 1997-1998 in East Asia, and decreased to 37 by the time of Vietnam’s accession to WTO in 2006. During this period, when Vietnam had not been open to the 100% foreign capital banks, foreign bank branches were constantly set up.

Figure 1.1. Capital raising and lending by various types of banks in Vietnam

![Figure 1.1. Capital raising and lending by various types of banks in Vietnam](image)

Source: Annual reports by SBV for 2005-2011; 2012 and 2013 data are estimated by the authors.

After the accession to WTO in 2007, the Vietnamese banking sector welcomed the advent of 100% foreign capital banks.\(^3\) Moreover, SBV approved for the conversion of 13 rural into urban banks and

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\(\text{3 Five 100% foreign capital banks were licensed including: ANZ Vietnam, HSBC, Standard Chartered, Sheehan Vietnam, and Hong Leong Bank.}\)
licensed to three new urban JSCBs – Bao Viet, Tien Phong, and Lien Viet – upon Decree 141 in 2006. It is noteworthy that the founding shareholders in these banks mainly are the state-owned businesses/economic groups or SOEs that have gone public in which the state still have dominant shareholdings. In addition to banks, financial institutions (FIs) include finance companies, financial lease companies, and a great deal of people’s credit funds (see Appendix 1) under the SBV’s governance and supervision.

Sharp increases in the quantity of banks for a short time lead to a debate of whether there are too many banks in Vietnam. This study does not aim at this debate, but points out that the conversion of rural into urban banks and the advent of new banks lead to imbalanced allocation between rural and urban areas, farmers and city dwellers, agriculture and other sectors, production and monetary sectors, and especially interest groups and the rest of the economy.

Importantly, the increased quantity of banks has not been accompanied by improvements in effectiveness and governance capacities. Weaknesses – low governance standards, weak and unresponsive management, slow-to-renew accounting standards, weak monitoring system that is ignored and not de facto complied with, poor enforcement – began to reveal. Although profit might be high in a few years, it is not a result of good performance, and simply reflects the financial repression and increased risks in the banking system. In fact, these risks have actually happened in recent years as previously warned. As profits are principally spread out in the long term, banks are forced to use the past high profits to cover the current troubles on their own.

In short, Vietnam’s banking system has evolved into a variety of banks under diverse ownership from a monobank system. Diversification of ownership is necessary because it enhances the competitiveness in the financial sector. State-owned commercial banks (SOCBs) which used to take dominant positions in most of banking activities from capital raising to lending have reduced their roles, while JSCBs have gradually become their counterparts and played critical roles in development, competition and stabilization of Vietnam’s financial system.

1.1.2. The rapid growth of capital and assets

Set aside a large number of people’s credit funds with very small sizes, JSCBs have been rapidly growing in terms of their quantity and scope of operations. Their development, however, is not evenly. Except for a few JSCBs with significant sizes and strong financial potentialities being matching with state-owned counterparts, the others have small sizes and poor financial and managerial capacities. Decree 82/1998/ND-CP dated 03/10/1998 by the government required the

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5. Note that during this period, Decree 24/2007/QD-NHNN did not pose any conditions to restrict the right of SOEs to contribute capital for bank establishment. However, Circular 09/2010/TT-NHNN dated 26/3/2010 additionally required that shareholders who are SOEs have to be approved by the Prime Minister in a written document to contribute capital for bank establishment (Section 2 Article 5).
6. Currently there are more than 1,100 local people’s credit funds with VND100 million legal capital each and a central people’s credit fund (which has transformed into cooperative bank) with legal capital equivalent to that of a JSCB. People’s credit funds in Vietnam are operating as cooperative banks under both regulations on financial institutions and cooperatives.
VND50 billion legal capital for an urban JSCB\(^7\) and only VND5 billion for a rural counterpart. This legal capital was even much lower than the previous one specified in Decision 67/QĐ-NH5 dated 27/3/1996.\(^8\) Although the legal capital requirement was not based on firm economic fundamentals, the regulator’s intent seemed to be clear, in particular, to create various market segments in banking activities. Since 2006, however, aiming at increasing financial capacity of the banking system to meet the requirement for competition in international economic integration, the government promulgated Decree 141/2006/ND-CP to replace Decree 82, which did not discriminate between rural and urban banks anymore and required the overall legal capital of VND1,000 billion (by late 2008) and VND3,000 billion (by late 2010) (see Appendix 2).

**Figure 1.2. Banks that have not sufficiently raised legal capital by late 2010 (billions of VND)**

![Graph showing banks' capital levels](image)

*Source:* Compiled from banks’ financial statements.

Before Decree 141 was issued and came into effect, SOCBs (except MHB) and some large JSCBs had excess charter capital. After Decree 141 came into effect, many JSCBs who soon had had plans to increase capital were successfully raised sufficient or excess required legal capital, while some, especially rural JSCBs, faced difficulties or were not even able to raise capital as required.\(^9\)

The fact that many banks have to raise capital for a short time while the qualified banks also go on raising new capital has put significant pressures on bank shareholders regarding the demand for capital, especially when the securities market is not as favorable as it was before. The increased cost of capital is one of reasons for ever-increasing lending rates, especially in the context of tightened monetary policy by SBV.

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\(^7\) Except for urban JSCBs in Ha Noi and HCMC with VND70 billion legal capital.

\(^8\) According to Decision 67, the minimum charter capital for an urban JSCB was VND150 billion in HCMC, VND100 billion in Ha Noi, and VND50 billion in other provinces; it was VND10 billion for a rural JSCB with branches and VND3 billion without branches.

\(^9\) By late 2008, five banks have not sufficiently raised VND1000 billion capital each as required: DaiA Bank (VND500 billion charter capital), TrustBank (VN504 billion), Mekong Development Bank (VND500 billion), pre-merger Ficombank (VND610 billion), and a SOCB - MHB (VND817 billion).
Figure 1.3. Charter capital in Vietnamese commercial banks (billions of VND)

Source: Compiled from banks’ financial statements.

Raising capital should be made based on the own demand for capital by each bank to enhance its financial protentiality and competitiveness, but it was administratively required in Vietnam, and hence became a pressure on banks to raise capital forcedly, making some of them face financial difficulties. Their aim at finding strong strategic investors who understand the banking sector and possess good management skills has to be ignored to find instead those who have money but are not professional or the interest groups who want to turn the bank into their own capital supplier for their ambitious and risky projects.

Together with the pressure of capital raising is rapid increases in deposits and loanable funds in the banking system. This response is natural to ensure the targeted returns on equity (ROE) of the banks. Since 1998, the growth rate of bank credit has been very high in the banking sector, especially between 2006 and 2010, it was up to 35%, an unprecedented growth rate in the region (Figure 1.4). The rapid growth of assets poses not only a challenge of banking management by higher standards from the microeconomic point of view, but also a big challenge of governance and monitoring framework from the more complex macroeconomic point of view.
Figure 1.4. Bank credit a percentage of GDP (%)

Source: Database of Economist Intelligence Unit.

1.1.3. Overlapping ownership comes out and is getting more complicated

The period 2005-2007 witnessed a boom in securities market, where stocks in banks became bluechips. Bank shareholders, via shareholders’ meeting, widely agreed to raise capital in the hope to resell new shares at premiums. Meanwhile, many new investors were not only individuals but also firms which had been operating in the manufacturing sector and now began to take part in the banking sector. Stock issues to increase the JSCBs’ equity came out more frequently. In general, the zeal in the securities market and regulation on commercial banks' legal capital led to rapid increases in equity of the banking system as a whole.

Figure 1.5. The growth of the securities market and commercial banks’ charter capital (billions of VND)

Source: SSC and compiled from JSCB’s financial statements.
Also during this period, many public corporations were upgraded to economic groups and allowed to be operating in many sectors, including the financial banking sector. As a result, a series of public corporations and state-owned economic groups began to own banks. In the meeting in May and June 2012, the multidiscipline business operations are still allowed in the Restructuring Project submitted by the Government to the National Assembly. Similarly, SOEs, gone public or not, increasingly own banks or contribute capital to set up new banks. For instance, among the founding shareholders in all of three new commercial banks (CBs) set up in 2008 are SOEs.

On one hand, the demand for capital raising in banks and the outside investors’ participation have mutual interests; on the other hand, making investments in the banking sector as dominant shareholders without minimum qualifications necessary for strategic investors is very risky. The banking sector always has its own strict restrictions and conditions but when the pressure of capital raising is threatened, standards are often relaxed or even the banks’ non-compliance is not punished.

It is noteworthy that since 2008, when the securities market had come into a bust, and stock issues by banks to raise capital had become more difficult while the deadline of legal capital raising was looming, banks began to loophole the capital adequacy regulation. Banks made use of some tricks of virtual capital raising to comply with the regulation while complex cross ownership links were created to avoid from the SBV’s supervision. In other words, overlapping ownership is an effective way created by banks to avoid from current supervisory regulations, leading to negative impacts on the capital allocation and more risks to the system as a whole. Some reports by regulators has warned about this situation but the specific picture of overlapping ownership has not been finalized and remedies for overlapping ownership have not been radically and systematically adopted.

Problems in the banking system have gradually revealed since 2008 with violations of safety banking regulations particularly on capital, credit limits, liquidity, and bad debts. These have happened when safety regulations have been continuously developed approaching international standards as recommended by Basel Committee on Banking Supervision (BCBS). Violations of safety regulations by commercials banks have been identified. For example, in the report of orientation of and solutions to restructuring Vietnam’s banking system during 2011-2015, the SBV asserts “interest groups and cross ownership between financial institutions are so significant that would lead to very high systematic risks if a bank faces difficulty or goes bust,” “with various techniques, many subjects have not complied with safety banking regulations,” and “it is very hard to inspect, find out, and deal with cross ownership due to lack of legal evidence.” Despite the identification, the SBV has not pointed out any specific and legal evidence; moreover, it has not asserted if these behaviors have broken the law. This problem partly comes from the loopholes and inadequacies of current legal regulations regarding to the definition and identification of overlapping ownership as well as sanctions that are getting ineffective for

10 In 3/1994, the Prime Minister issued Decision 91/TTg dated 07/3/1994 on the pilot establishment of business/economic groups. However, they were initially called Corporations 91. In 3/2005, the Prime Minister decided to set up Vietnam Post and Telecommunication Group (VNPT) as a pilot. Since then, all Corporations 91 have transformed into pilot economic groups. Nevertheless, the Prime Minister had not issued the decision on the pilot establishment of state-owned economic groups until 11/2009.
systematic violations. This poses a requirement for revision and improvement of current regulation on the banking and supervisory activities on one hand, and enhancement of effectiveness of compliance and sanctions, getting rid of preferences and exceptions in complying with banking supervisory regulations in particular and adopting the law in general, on the other hand.

1.2. The research objectives

The study poses three groups of objectives including:

(i) Researching, overviewing experiences and international practices on overlapping ownership (OO) between financial institutions and economic groups.
(ii) Assessing the OO between financial institutions and economic groups and the oversight and consequences of OO in Vietnam.
(iii) Making recommendations on institutions to enhance the efficiency in monitoring financial markets in general and financial institutions in particular in Vietnam.

1.3. The scope of the research report

The research report analyzes the ownership structure of Vietnamese financial institutions, focusing on JSCBs, SOCBs, and some non-banking financial institutions to analyze and assess the compliance with the monitoring framework for financial institutions during 2006 – 2012. Since (individual and institutional) shareholders are very diverse in their shareholdings and the extent to which they dominate the banking operations, the report emphasizes on the major owners (major shareholders as currently defined in Law on Financial Institutions, strategic shareholders who are banks, shareholders who are economic groups, and other shareholders assessed as important actors in the banks’ decisions and operations).

In terms of ownership relations, the report focuses on the entities that involve in banking ownership including the state-owned financial institutions (or SOCBs), JSCBs, state-owned economic groups (or SOEs in general), non-state enterprises mainly including private economic groups with major shareholders being individuals and even local governments. These relations can be shown as a matrix:

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<th>State-owned banks</th>
<th>Joint-stock banks</th>
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<td>State-owned enterprises</td>
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The report also analyzes both direct and indirect ownership relations. These analyses help point out the complexity of ownership relations in the banking system and find out the loopholes and deficiencies in the legal system regarding the banking regulations, thereby explain how the current banking supervisory regulations can be easily neutralized.
1.4. Research method

This report summarizes the effort to research on overlapping ownership by the Fulbright Economics Teaching Program (FETP) for more than three years. Throughout the research process, the qualitative method, especially the expert method, case study and documentation study methods, especially for legal documents, are applied.

Regarding the data, knowing that overlapping ownership is an important and sensitive problem in Vietnam, the report mainly uses the official sources of data including banks' and firms' reports (financial statements, annual reports, disclosures, governance reports...), statistics, history data (credit data, stock transaction data...), published by public agencies (like the government, SBV, Ministry of Finance, State Securities Commission...), financial institutions, firms, securities companies, and some reliable media. An advantage of these official sources is that their information is verifiable. As a weakness, however, it does not necessarily capture fully and frankly the overlapping ownership in the Vietnamese banking system, which is very diverse and complex. However, we believe that this information can provide sufficient indicators (and warnings) to identify and analyze the nature of OO, based on which reasonable policy recommendations can be made.

Although priority is given to official information but additional media coverages are carefully consulted in necessary cases. In addition, the authors carry out some case studies (such as bank M&A), and interview subject matter experts in finance - banking\(^\text{14}\) to verify the accuracy of data, the convincibility of analyses, the reliability of findings, and the feasibility of recommendations.

1.5. Research structure

The report includes 4 chapters. Chapter 1 presents an overview of Vietnamese financial institutions, analyzes problems facing them, especially the ones coming from increases in OO among financial institutions and between them and banks. This chapter also shows the objectives and the scope of research.

Chapter 2 is divided into two parts. The first presents the framework of principal-agent relationship, focusing on clarifying the agency cost of equity and agency cost of debt. Based on this framework, the report points out problems resulting from the principal-agent relationship, analyzes principled measures to deal with and restrict the asymmetric information in general and the consequences of the principal-agent relationship in particular. Moreover, this chapter begins with an analysis of impacts of ownership structure on the banks' attitude toward risk based on both theoretical frameworks and experimental evidence across countries. The next part identifies CO structures in banks – focusing on pyramidal and cross ownership – and analyzes its benefits and risks for the banks themselves, the financial system, and the economy. The last part explores experiences from some countries, whose financial systems are also based on the banking system as in Vietnam, and especially which used to experience or have been experiencing overlapping ownership, such as Japan, German, Italy, and China, to draw lessons on banking supervision in Vietnam.

\(^{14}\) Personal interview or via seminar on cross ownership held recently, as well as comments and suggestions by subject matter experts in the field of the report.
Chapter 3 uses data compiled from financial statements, management reports, and case studies to show the current state of overlapping ownership in Vietnam’s banking system and analyze its negative impacts on the safety and health of the financial system, non-performing loans (NPLs), non-compliance with the banking supervisory framework, and other potential risks. Overlapping ownership relations from simple to complicated, from direct to indirect, and between various economic actors (as shown in the matrix [5x2] Section 1.3) are analyzed via typical case studies, such as the merger of the three CBs. Having identified these overlapping ownership relations, the report analyzes failures of the supervisory framework, regulations, the compliance with current banking safety limits, impacts on the quality of the banks’ assets and NPLs, resolution to weak banks, the role of audit, inspection, and sanction for financial institutions, shareholders, and dominant shareholder groups.

Finally, Chapter 4 make institutional recommendations on overlapping ownership to enhance the supervision of the financial system in general and the financial institutions/groups in particular in Vietnam. Accordingly, the recommendations focus on: (i) Mitigating the conflict of interests between policy makers and those who bear the impacts of the policy; (ii) Reducing the bankers’ moral hazard; (iii) Reducing the capture of power by interest groups by separating ownership and control rights; and (iv) some technical suggestions to improve current regulations on banking safety.
CHAPTER 2
THE PRINCIPAL-AGENT PROBLEM, OWNERSHIP RELATIONS
AND THE BANKS’ ATTITUDE TOWARD RISKS

2.1. The principal-agent relationship
2.1.1. Asymmetric information and the principal-agent relationship in banks

A bank is an intermediary financial institution that takes deposits from savers to lend to investors. This intermediation leads to two types of contractual relations – one of the bank and depositors and the other one of it and borrowers. In the former, depositors act as the principals who delegate the bank to make loans with their deposits. The bank then exercises the delegation as an agent by lending to investors. In the latter, the bank acts as the principal who delegate investors/borrowers to use the loans for certain purposes. The investors then exercise the delegation as agents by investing for the purposes specified in the lending contracts.

As an inherent problem in the principal-agent relationship, there is an information asymmetry between the principal and the agent. For example, depositors cannot certainly know if their deposits are carefully and properly used because only banks know how the mobilized funds are reimbursed. Similarly for the relation between the banks and investors, banks find it hard to know for sure if loans are properly used for the right purposes as specified in the loan contracts; only investors know.

Information asymmetry is a main source of risks in loan contracts. The economists distinguish between two types of risks due to asymmetric information. First, the moral hazard occurs when the agent takes advantage of the fact that her/his behaviors cannot be closely observed by the principal to act in her/his own interest at the principal’s expense. For example, an investor may take advantage of the fact that the bank does not know how the loan is used, and hence, she/he uses the borrowed money that should have been invested in production to pour into real estates or securities.

Second, the adverse selection occurs when the agent takes advantage of the fact that her/his information cannot be clearly verified, and hence, acts in her/his own interest at the principal’s expense. Look at the above example again. Before lending, a bank always make appraisal of the investor’ credit profile. Clearly, for a given interest rate, the bank wants to lend to a project which has a lower level of risk. An investor, however, may want to assume a higher level of risk for a higher return. As a result, when the bank chooses to loan to a project based on interest rates, the riskier the project is, the easier it is to get the loan; it is called adverse selection.
Thus, from the point of view of the agency problem, when information or behaviors are deliberately hidden, banks and their stakeholders may suffer risks. As an agent, a bank has to secure its financial obligations to depositors (the principals). However, loans provided by the bank, as a principal, are not always paid back in full by borrowers (the agents). The fact that borrowers fail to pay back to the bank does not mean that the bank is allowed to deny its obligations to depositors. As above analyzed, the higher this risk, the greater the difference between lending and deposit rates (also known as net interest margin, or NIM) created by the bank. NIM reflects the cost of financial intermediary, or the agency cost – a form of transaction cost. In short, the more serious the asymmetric information, the worse the agency problem, and the higher the agency cost.

For a bank, the principal-agent relationship exists between not only depositors and the bank but also it and borrowers, minor and major shareholders, shareholders and the board of management, the board of management and the board of directors, and the board of directors and staff (Figure 2.1). Thus, the bank, as a financial intermediary, contains an interlacing net of principal-agent relationships and asymmetric information inherent between parties. When the asymmetric information is not reduced and contracts between the principal and the agent are not strictly enforced, the agency problem comes out. It is because parties always have different, even conflicting, objectives, priorities, and motives, while it is hard and costly for the principal to appraise information and monitor the agent’s behaviors and information due to asymmetric information. In a bank, the most serious agency problem usually occurs between shareholders/owners and the board of directors and between shareholders and creditors.

2.1.2. The agency cost of equity

The agency cost of equity incurs when a manager, as an agent, makes business decisions to maximize her/his own benefits rather than the shareholders’ - the principal. For example, the manager may “expand her/his empire” by expanding the size of the business in excess of the optimal level. Or the manager may decide to move away from the core business to create opportunities for her/his own backyard firms. In doing so, the manager increases her/his own authority through her/his ability to use and dispose of more resources, raises her/his own compensation by increasing sales, reduces the risk of being fired, or simply secure personal profit.
In these cases, minor shareholders suffer the most part of losses. Since they cannot directly involve in controlling the firm, they have to entrust the major shareholders to govern the firm and hire executives. Problems may occur if interests of a small number of major shareholders are not identical with those of a large number of minor shareholders. For example, major shareholders may choose to hire managers to serve their own interests rather than all shareholders'. In general, minor shareholders usually lack of information and find it hard to oversee the managers' and major shareholders’ behaviors. Hence, the bank funds may be poured into projects that accrue the best interests to major shareholders, while risks are spread over all shareholders. Minor shareholders may even bear unproportionally greater risks relative to their stakes.

Major shareholders may ask the bank CEO to lend to a certain customer – that is, directed credit or related credit – in stead of looking at the project feasibility, the borrowers' financial and managerial capacities. Pursuing these interests, major shareholders usually seek to establish an ownership structure such that their shareholdings need not so large to be dominant, it is just enough to ensure that they can control or dominate executive decisions. It is because they will have to bear the large part of risks if their shareholdings are dominant; and if their shareholdings are just sufficient to control, the large part of returns will render to them while risks are spread over all shareholders.

Thus, shareholders in general, especially minor shareholders and stakeholders, may suffer if these risky behaviors lead to losses. To avoid from these behaviors, regulations on ownership limits and responsibilities for financial information transparency and executive processes are very important. In principle, in an environment of highly asymmetric information, to avoid from major shareholders' manipulation, the ownership should be either highly dispersed toward the public or concentrated in a small group of shareholders (as an extreme, a single shareholder own 100% of the firm). In the presence of asymmetric information, responsibilities for information transparency helps enhance the market oversight, restrict the executive’s risky behaviors in the name of some major shareholders’ interest, ignoring that of the public shareholders.

2.1.3. The agency cost of debt

The agency cost of debt comes from the interest conflict between creditors and shareholders. When safe projects are chosen for investment, the firm can secure its obligations. The more safe the projects, the more secured the creditors' benefits, but the more modest the benefits left over to shareholders, because the project returns, which are usually lower due to its safety, have to give priority to paying back creditors first, and then to shareholders. In other words, shareholders receive the residue after all obligations to creditors have been made.

In contrast, if the project is very risky, and hence, its return is high, shareholders get more benefits. That is why shareholders want to choose risky projects for high returns, because in case the project is successful, they get more benefits, and if it fails, they may choose to refuse to carry out their obligations and transfer the control rights to creditors on the basis of limited liability.

Hence, there is an interest conflict between shareholders and creditors in levered firms, because shareholders assume limited liability within their capital contributions but they can make use of debts. The higher the debt-equity ratio, the greater the potential risk to creditors. CBs are
characterized by making loans with deposits, which comes for the large part from depositors; hence, unlike ordinary firms, the bank’s debts are always many times higher than equity contributed by shareholders. This induces bank shareholders to take more risks, and then losses, if any, would be borne by depositors, while shareholders assume limited liability within their capital contributions about 1:10 of customers’ deposits. This risk is called moral hazard, a consequence of asymmetric information. Accordingly, commercial banking supervision is an important function of the central bank and banking regulators in countries. Regulations on capital adequacy and safety ratios are imposed to create a supervisory framework and contribute to preventing from bankers’ moral hazard and taking risk excessively.

2.1.4. The ownership structure and the attitude toward risk

Among the early research on governance consequences of separating between management and ownership, and hence, interest conflict between the manager and shareholders, is the study by Jensen and Meckling (1976). Traditional theories of agency problem point out that managers often pursue various objectives and exhibit attitude toward risk different from the bank owners do. Shareholders who have diversified portfolio have incentives to take more risk for higher expected returns, while managers want to take less risk to secure their positions, credibility, occupational benefits, and human resources embodied in themselves (Galai and Masulis, 1976; Esty, 1998; Jensen and Meckling, 1976; Demsetz and Lehn, 1985).

Experimental studies by Saunders et al. (1990) test the relationship between the bank ownership structure and the attitude toward risk, especially in the context of relaxed regulations on the financial system. Studies suggest a positive relationship between the size of the manager’s ownership (measured by the manager’s shareholding) and her/his taking risk. Research also points out that during the time of relaxed financial regulation 1979-1982 in the U.S., banks controlled by shareholders take more risk than those controlled by managers. Likewise, a study by Sullivan and Spong (2007) suggests that hired managers who hold shares in banks exhibit a positive relationship with improvements in the banking efficiency, e.g., hired managers run the banks closely in the shareholders’ interests under certain conditions.

In general, managers are often afraid of risk because they are not able to diversify the risk of being unemployed (Amihud and Levy, 1981), while shareholders tend to take risk more easily (Hirshleifer and Thakor, 1992). However, the extent to which owners take risk depends on the extent to which the ownership is concentrated in the bank. Banks with dispersed ownerships have better incentives to be neutral with risks (Jensen and Meckling 1976, Demsetz and Lehn 1985, Esty 1998) due to their ability to diversify risks in various projects. Moreover, shareholders with dispersed ownerships have less incentives to oversee the manager because they have to share the benefits of the oversight with those who are indifferent to managing activities. In contrast, major shareholders often have incentives to monitor the manager’s activities, and hence, can control her/his behavior of taking less risk (Mork et al. 2005, Stultz 2005).

Laeven and Levine’s research (2009) shows that the relationship between the bank’s risk and capital adequacy regulations also depends on the its ownership structure. Facing higher requirements on capital, bank shareholders tend to choose riskier investment strategies to cover losses of the cost of
capital. In other words, tightened regulations on capital and other banking regulations correlate with higher risk for banks which have sufficiently strong owners. Laeven and Levine (2009) provide experimental evidence on the positive correlation between the level of risk the bank assumes and the relative strength of shareholders. This finding is also suitable to that of Saunders et al. (1990) that banks under the shareholders’ direct control tend to take more risk than those run by managers and whose owners have dispersed shareholdings.

A study by Barry et al. (2009) provides some controversial findings. Controlling various factors, the study finds that the asset risk is lower in banks whose shareholdings dominated by families and individuals who have less diversified portfolios. However, evidence shows that lower risks are accompanied by less profits. In general, banks owned by families can give up maximizing profits because they have undiversified portfolios and cannot separate financial priorities from outside shareholders. These families also restrict executive positions to family members, which may lead to limited managerial competence and reduced competitiveness relative to banks that do not owned by families (Mork et al. 2000).

Meanwhile, a study by Laeven (1999) looks at different forms of bank ownerships including state, foreign, corporate, and family ownerships. Based on data of Asian countries before the crisis of 1997, Laeven (1999) finds that banks owned by families and corporations are among the riskiest ones, while foreign banks relatively assume less risk.

Another line of research focuses on comparison performance by state-owned and non-state banks from the point of view of agency cost. The agency cost in the governmental bureaucracy can lead to bad managerial incentives and resource misallocations. According to the theory of agency cost, public managers have less incentives to exert their best efforts than their private counterparts; instead, they have incentives to move resources toward their own interests. From the political point of view on state ownership, state-owned banks are inefficient because the politicians’ purposeful policies is to transfer resources to hold up their political positions (Shleifer, 1998). This is proved in research by Berger et al. (2005) and Iannotta et al. (2007), suggesting the poorer performance and the greater credit risk in state-owned banks than in private banks.

Besides conflicts between owners and managers and differences in public and private ownerships, some studies explore the role of non-financial institutional investors. Non-financial institutional investors usually hold an important voting position in the bank, and hence, help shape the attitude toward risk. Institutional investors can play better the controlling role thanks to the economies of scale in monitoring firms. Research by Pound (1988) emphasizes that institutional investors can enforce the control right at a lower cost because they have more experiences. However, it is possible that managers and institutional investors establish alliances to give priorities to internal interests rather than maximize the bank value. Furthermore, regarding the bankruptcy risk, research by Barry et al. (2009) suggests that the probability is higher when a non-financial company or institutional investors hold more shares in the bank. However, this risk has no implications on listed banks because the market helps better oversee the shareholders’ attitude toward risk.
2.2. Ownership structure in theories

2.2.1. Pyramidal ownership

Benjamin Graham and David Dodd (1934) devote an entire chapter in their book to the pyramidal ownership in the U.S. firms. Pyramidal ownership in corporate finance is to create a speculative capital structure by establishing a parent company or a series of parent companies to take control of other firms or take over business operations with little or even no investment capital and capture a large part of profit and the firm value. According to La Porta et al. (1999), pyramidal ownership is a form of ownership whereby entities have ownership relations along a chain of top-down controlling. In this form, the ultimate owner is on top and the lower layers of firms are intermediaries as both owners and being owned. An ultimate owner is a shareholder who takes full control of a firm and is not subject to control by any one else. An intermediate consequence of pyramidal ownership is the separation of ownership and control in firms of lower layers. This separation exists because ultimate owners, via this ownership structure, can establish their control right unproportional with their capital commitments in firms of lower layers. In other words, based on pyramidal ownership, ultimate owners can take control of firms without contributing capital for actual shareholdings in firms.

Figures 2.2, 2.3, and 2.4 present different forms of pyramidal ownerships. Figure 2.2 shows a simple form of pyramidal ownership, in which Firm A owns Firm B and Firm B owns Firm C. Thus, with this ownership structure, A indirectly owns C. If A dominantly owns B and B dominantly owns C, then A can take control of C although it has no shareholding in C. In this case, if C is controlling another firm, A will be controlling it. Hence, A is regarded as the ultimate owner in this pyramidal ownership. Moreover, although A does not directly own C, A and C need to be considered affiliated entities, because A can dominate C via B. Similarly, Figure 2.3 is an expansion of Figure 2.2, in which A also plays the role of the ultimate owner in E and C. In this case, not only A and C as well as A and E, but

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16 Graham and Dodd 1934.

17 La Porta, R., F. Lopez-de-Silanes and A. Shleifer (1999), Corporate Ownership around the World, Journal of Finance 54 (2).

18 Note that in many cases, 50% shareholdings do not ensure the control right. However, the opposite can happen, that is, a shareholder with less than 50% shareholding can take control if the remaining shares are dispersed over minor shareholders or a provision in the firm charter restricts the other shareholders’ voting rights.
also D and B as well as E and C are potentially affiliated. Meanwhile, Figure 2.4 shows that both E and C are the ultimate owners in A. However, those who take control of A may be either E or C or both of them or no firm in this group. Regarding the affiliation, E and A are affiliated, while A is affiliated with C, then E and C, as well as D and B are potentially affiliated.

Piramydal ownership exists not only in developing countries with weak legal systems and underdeveloped capital markets but also in developed countries. La Porta et al. (1999) contend that pyramidal ownership exists in developed countries because the origin of the civil law and institutions are presumably weak in protecting investors. Studies by La Porta et al. (1999), Claessens et al. (2000), Faccio and Lang (2001) suggest that firms controlled through pyramidal ownership account for 20% of total firms in Western European countries, 9% in the U.S., up to 35% in Canada, very high in Eastern Asia with 67% in Indonesia, 55% in Singapore, 49% in Taiwan, and 37% in Japan.

2.2.2. Risks and benefits of pyramidal ownership

2.2.2.1. Benefits of pyramidal ownership

Pyramidal ownership can bright about mixed benefits to both inside and outside entities, notably to entities inside the ownership group. First of all, this form of ownership can prevent or mitigate negative outside impacts or make up deficiencies of the capital market. Pyramidal ownership itself creates a reduced capital market where firms can find inside suppliers of capital or supplement their temporary surplus funds to exploit the turnover of capital at most. In emerging economies, capital markets are underdeveloped or inefficient. Therefore, to enhance the efficiency in capital allocation, firms usually create pyramidal ownership to make up for deficiencies in capital markets (Khanna and Rivkin).

Moreover, for countries where the indirect financing form, mostly via the banking system, plays the central role, pyramidal capital structure tends to be pervasive in the banking sector. Firms have incentives to own banks to turns them into the effective direct financial gates to finance the firms’ business activities. Since banks often have large sizes, however, it is costly and hard, due to legal restrictions, to hold direct control rights in banks. Accordingly, pyramidal ownership is a way for ultimate owners to take control of banks, although their shareholdings are not large, or even they do not directly own banks (also known as shadow owners). Benefits from owing banks are obvious; for example, stable financial sources are available at low costs or some requirements in providing credit are ignored.

In addition, using common resources and sharing information and customers are another benefit from pyramidal ownership. With pyramidal ownership, the minor shareholders’ ability to dominate banks or the outside investors’ ability to step in is limited, and hence, ultimate owners can pursue their long term development strategies and values. Furthermore, having low shareholdings but still taking control of firms, the ultimate owners are actually using a higher financial leverage. This can

20 Recited from Attis et al. (2002).
increase ROE to owners if the capital is efficiently used. In contrast, a high financial leverage accompanied by an inefficient use of capital would be a disaster.

The ultimate owners have authority, and hence, informative advantages, based on which they can simplify the firms’ policies toward maximizing their values in their own interests, even at their partners’ or minor shareholders’ expenses. In addition, due to pyramidal ownership, ultimate owners can design policies to transfer the firms’ resources to regulate prices and trading volumes inside the group and dividends paid to firms, carry out cross-finance and tax avoidance, and exploit tax incentives.

When a firm faces a risky project, the investment may generate big profits or losses or even lead to bankruptcy. In this case, putting the whole project in the parent company would lead to the risk that the ultimate owners would assume almost unlimited liability to the possibly incurred losses. Then, based on pyramidal ownership, this liability can be shared by or allocated to firms of lower layers.

2.2.2.2. Risk and cost of pyramidal ownership

Pyramidal ownership can lead to the agency cost. Grossman and Hart (1988),22 and Harris and Raviv (1988)23 contend that pyramidal ownership undermines the one-share-one-vote rule. Pyramidal ownership serves as a controlling tool so that major shareholders can expropriate minority interests (F. Jens Köke, 1999).24 Major shareholders would direct the cash flows and interests for their own sake, rather than for all shareholders’, even though in principle, cash flows to shareholders depend on their actual shareholdings in the firm. In firms with half-dispersed/half-concentrated ownership structures, the agency problem of form 2 is more serious.25 In this case, some major shareholders exert their influences on the managers while minor shareholders are dispersed and unorganized. This is why minor shareholders themselves cannot share the cost of oversight and control on the managers who are nominally employed to run the firms. As a result, managers would behave in their own interests, or actually in the major shareholders’, while risks are shared by all shareholders. In a pyramidal ownership structure, the ultimate owners hold the control rights; they stay behind the major shareholders and dominate their behaviors. In turn, major shareholders dominate the managers’ behaviors or directly play the managers’ role. In the banking sector, this may lead to serious consequences. Managers are often forced to extend preferential credits to firms or projects under the ultimate owners’ control. Safe banking regulations are usually ignored or not fully complied. Also, regulations on internal supervision may not work in this case, while the external oversight function of inspection agencies is limited or even neutralized due to the complexity of the ownership structure. This situation tends to be more pervasive in countries with weak legal and institutional frameworks.

24 New Evidence on Ownership Structures in Germany. ZEW Discussion Paper No. 99-60
25 The agency problem of form 1 refers to the relationship between owners and managers, i.e., arising from the separation of owners and managers, while the agency problem of form 2 reflects the interest conflict between controlling and non-controlling shareholders. Both forms, however, lead to the fact that managers do not act in the shareholders’ interests.
Furthermore, according to Bebchuk et al. (2000), the pyramidal ownership structure can help ultimate owners take control of firms with very small shareholdings. Graham and Dodd (1934) suggest that it is unfair to take control of firms with small capital thanks to the pyramidal ownership structure; it makes the firms’ management policy non-transparent and unaccountable. If an ultimate owner can control a firm with small shareholding, there will be incentives for her/his to take control of other firms or set up the new ones. If too many firms are under control of an ultimate owner or a group of ultimate owners, it is very likely that they can manipulate an industry or even the economy. This can lead to decreased efficiency, increased monopoly, and dampened competition and creativity (Bany Ariffin and Law 2008; Facio and Lang 2002).

Attis et al. (2002) contend that the affiliation of firms in the pyramidal ownership chain helps ultimate owners capture the firm assets by establishing unreasonable provisions to transfer assets within the group, simplify the firm decisions, direct dividend policies, and carry out cross lending and co-insurance. For example, in Figures 2.2 and 2.3, the ultimate owners can direct profits from Firm C or Firm E to Firm A by designing a clever dividend policy. Likewise, there are other forms of resource extraction (aka tunneling) including too high/low lending rates, sales of inputs or purchases of outputs at non-market prices, and asset leases or loan guarantees among affiliated firms. If resources transfers become pervasive, they can cause damages to the economy. For example, some accused that the crisis of 1997-1998 in Asia arose from the resource extraction. In general, minor shareholders suffer the taxes in the presence of resource extraction and this hampers the financial development. Resource extraction also induces transaction costs; it may hide accounting figures so that it is hard to audit and inspect and the valuation of the firms’ financial health becomes useless. Moreover, pyramidal ownership can have impacts on economic development and market stability. It is because the ultimate owners usually have political connections, and hence, control rights on resources (natural resources, land, credit), prices, production, and even distribution of goods (Attis et al. 2002).

Besides these risks, Graham and Dodd (1934) point out other risks in financial investments resulting from this ownership structure, such as profit overstatement, distortion of dividend policy, book value overstatement, overexploitation of warrant. However, Graham and Dodd (1934) also suggest that not all pyramidal ownership structures are created for this purpose. In fact, many economic groups with pyramidal ownerships have healthy financial conditions and play an important role in some national economies.

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27 According to B. Ariffin (2009), in Malaysia, the Parit Perak Group held by Senator Lee Lay Seng with a shareholding value of only RM4 million can effectively control 23 other firms with up to RM446.4 million value thanks to pyramidal ownership, Pyramidal Ownership Structure and Agency Problem: Theory and Evidence
30 A warrant is a derivative that allows its holder to buy common shares in the issue firm at a specific price for a specific period of time. A warrant is usually issued in couple with bond or preferred stock to increase benefits and attractiveness of the issue.
2.2.3. Cross ownership

Cross ownership is a complex relationship in various forms. In general, cross ownership refers to the fact that a Firm A holds shares in a Firm B while B also holds shares in A (Figure 2.5). In other words, cross ownership is a phenomenon in which firms hold shares in one another. In the simplest form, entities in cross ownership are only two firms. However, as shown below, there are more complicated forms.

It is necessary to distinguish between cross ownership with the case in which firms hold shares in one another by means of financial investments. In particular, it is called cross ownership only if firms hold shares in one another sufficiently to take part in the board of management or influence the planning and governance. This qualification is to distinguish from the case in which firms make financial investments and it is inevitable to hold shares in other firms in their portfolios. In this case, portfolio investments are made for capital gain rather than dominating other firms’ operations.

A more complicated form of cross ownership is circular ownership, in which Firm A owns shares in Firm B, while B owns shares in C, and in turn, C owns share in A (Figure 2.6). The circular ownership can expand with more intermediary firms. In circular ownership, it is hard to see where it begins and ends. In this case, it is much more difficult to determine the actual shareholdings in firms. For example, A does not directly own C, but B which is owned by A directly owns C, so A effectively owns C. Since C also owns A, however, determining the actual ownership ratio (or the voting right) by A in C requires the adjustment via B and the balance of the mutual ownership between A and C. In short, it is hard to determine the actual shareholdings in firms with circular ownership.

And yet, circular ownership is not the most complicated form of cross ownership. There is a phenomenon in which the ownership relations between firms are interlacing with direct and indirect ownerships like a matrix, and it is called network ownership. As shown in Figure 2.7, not only the pairs of firms A-B, B-C, C-D, and A-D but also A-C and B-D are affiliated. Moreover, these are just direct ownerships, not to say the indirect ones. For example, A has not only direct but also indirect ownership relation with C, because A directly owns D and D directly owns C. The network ownership is very complicated, and makes it hard, or even impossible in the context of non-transparent and unverifiable information, to determine the actually dominant ownership by a firm in another one.
In EU and the U.S., the concept of “cross ownership” is often used in media and telecommunication to show the fact that a communication firm owns two or more other firms in the same or related industry to create the monopoly power and reduce competition. In corporate governance, some scholars who research the separation of ownership and control define “cross ownership” as above strictly mentioned (La Porta et al, 1999)\textsuperscript{31}; the others refer to “cross ownership” with a broad implication that a central firm hold ownership rights in many firms which in turn may own each other (it is not necessarily the network ownership like in Figure 2.7). According to Bebchuk et al (2000)\textsuperscript{32} this model is different from the pyramidal ownership model in that firms link horizontally with one another in cross ownership to strengthen and root the power of the central controlling firm. Thus, the voting rights to control a group still disperse over firms in the group, rather than concentrate in any firm or owner.

In fact, ownership relations between firms are more complicated because not only the above ownership matrix can be expanded but also the definition of ownership relations are more open.\textsuperscript{33} That is, there are not only direct or indirect but also shadow ownerships. Family or kinship ties between individual shareholders and labor and economic relations between firms (suppliers, agents, customers) also complicate the definition and identification of ownership structure. In this study, in addition to the concept of “pyramidal ownership” and “cross ownership” as defined in the beginnings of Parts 2.2.1 and 2.2.3, the authors use the concept of “overlapping ownership” with a broader implication to identify the firms’ and banks’ ownership structures. “Overlapping ownership” covers both pyramidal and cross ownerships as narrowly defined and the later as broadly defined. Moreover, the authors look at not only the purely ownership rights of shareholders in firms but also other dominant rights by shareholders due to social, or economic, or legal ties, even if they do not have direct or dominant shareholdings in the firm’s capital structure. This is very important in developing countries, where the legal systems in general and the banking supervisory regulations in particular are not complete and informal institutions are very substantial in dominating social and economic relations. This study does not aim at building a normative definition of overlapping ownership; rather, it provides an open idea for further discussions. Also, this idea serves as a basis on which solutions to developing standards for more effective identification and banking oversight can be advanced in the institutional context of Vietnam.

\footnotesize{\textsuperscript{31}La Porta (1999), Corporate Ownership around the World, Journal of Finance.  
\textsuperscript{32} Lucian A. Bebchuk, Reinier Kraakman, George Triantis, Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights.  
\textsuperscript{33} See Appendix 4 for more details of other forms of overlapping ownership.}
2.2.4. Benefits and risks of cross ownership

Like many economic phenomena, cross ownership itself is not bad and not good. In other words, cross ownership contains both benefits and risks. Depending on the level and circumstance – such as the internal governance environment and the external regulating environment – some good (or bad) aspects of cross ownership emerge, resulting in the allegedly good (or bad) overlapping ownership. Let alone the topic of the level and circumstance of cross ownership, this section analyzes its benefits and risks.

2.2.4.1. Some benefits of cross ownership

First, cross ownership creates and maintains stable sources of funds for firms, which in turn serve as the stable and prospective customers of the bank. When a firm in the ownership links is in need of funds for its development demand, the bank plays the role of a financial provider to meet the firm’s demand for not only long-term capital but also working capital and its liquidity. In turn, the bank has a stable customer, and hence, stabilizes its income. Moreover, since the bank is also the owner of the firm, the credit risk facing the firm has impacts on the bank as both owner and creditor. Thus, the bank is likely to enhance its supervision on the firm’s operations.

Second, cross ownership helps reduce asymmetric information between banks and firms, and hence, strengthen the bank’s supervisory function and reduce the transaction costs. As the owners, banks can capture organizational and managerial information, as well as the financial efficiency and risks facing the firms. This makes banks reduce asymmetric information in their lending activity. The costs of gathering and processing information on the firms are lower for banks, and hence, the costs of financing firms are reduced. However, this is the other side of cross ownership when these benefits are distributed to those who engage in the cross ownership links at the outsiders’ expenses. The other side of cross ownership is discussed later when the risks of cross ownership are analyzed.

Third, cross ownership helps create a pool of common resources such as funds, customers, and governance, and hence, increase the economy of scale and the economy of scope for partners in the ownership links. These partners can take advantages of or share common interests to reduce the average cost and maintain the competitiveness of the group. For example, they can share customers or introduce and cross-sell their products. Due to common interests, overlapping ownership can tighten the relationship between business partners, reduce the negative impacts of external shocks or of changing macroeconomic conditions on business activities.

Fourth, cross ownership may potentially create links in the value chain, supporting industries, and clusters. Due to distribution constraints, partners have incentives to establish labor division and value division. If the ownership links are not tight, leading to inharmonious distribution of interests, partners will tend to concentrate on industries that have high returns or receive preferential privileges from the government, and ignore the sectors that have low returns or high risks and too many risks.

Fifth, cross ownership strengthens the power of the entire group, and hence, reduces the danger of hostile takeovers by others. Supplementary strategies of the group members help eliminate the
external interventions, keep the ownership structure stable and limit external conflicts or disputes. Thus, firms can choose neutral policies, and pursue their preset business goals. According to Adams (1999), the main purpose of cross ownership system may be to resist the risk of hostile takeovers by groups of competitors.34

Sixth, cross ownership may neutralize some government regulations, such as those on banking supervision, and hence, render to the ownership group the partial benefits that may not be in the interests of the economy as a whole. However, if the government regulations are unfounded or repressive, neutralizing them may bring about benefits in terms of efficiency to not only the ownership group but also the larger parts of the economy.

Thus, cross ownership itself can generate certain benefits. However, they are mainly accrued to partners of the ownership links. Meanwhile, benefits from cross ownership brought to the economy as a whole are little or unclear. In the case of Japan, cross ownership supported a lot the industrial policies during 1950-1970. However, this success also depended on the government policies in the context of Japanese industrialization (see Section 0 for more understanding about policy responses to cross ownership in Japan). In addition, in many cases, cross ownership may bring about risks and costs to external entities and hinder the competitive environment of the economy. The following section points out some risks of cross ownership.

2.2.4.2. Some risks of cross ownership

First, cross ownership may enhance the oversight capability as shown in the preceding section of benefit analysis, but cross ownership itself may be created to ignore the oversight role. Internal transactions are not carefully appraised and requirements are ignored. This behaviors are very dangerous for banks that decide to provide funds to their partners in the ownership group. Banking activities, especially the lending activity, are always governed by many stringent requirements. The central bank often imposes supervisory requirements and standards, from internal audits to external inspections. However, cross ownership may help banks ignore the supervisory standards that seem to be stringent, such as the standards and conditions for extending credits to customers within the ownership group. This risk, if any, not only affects the bank’s financial health but also endangers the entire financial system and stifle competition in the economy. Section 3.3.2 analyzes how cross ownership may neutralize safe banking regulations in the case of Vietnam.

Second, cross ownership may induce unreasonable, non-market transactions that do not base on prices and lead to distorted uses of resources. Non-market internal transfers of resources may lead to losses borne by other entities, such as the transfer pricing and the potential decreases in the government revenue. In the credit relations, firms that have ownership relations with banks can easily find sources of cross-funding for debt conversion that makes it hard to assess the credit quality and NPLs of banks.

Third, cross ownership may lead to creation of external shields and internal partial benefits that reduce the transparency of information on operations, governance, and finance. Among the main impacts are to weaken the competitiveness, discourage innovation and creativity, pursue out-of-date

business strategies, nurture bad ideas, and protect partial benefits. As a result, external investors may be concerned of a non-transparent business environment that discourage them to invest in industries infected with these diseases.35

**Fourth**, cross ownership may have negative impacts on the corporate governance environment. Arbitrary decisions often come out, suffocating independent ideas, while minor ideas are usually ignored. Arbitrary decisions often come from some interest groups in the firm, such as the groups of BOM members, or executive members, or major shareholders. There is a risk that these decisions are usually approved without being listened or taking feedback or providing benefits to all shareholders. In the long term, the minor benefits are put aside of corporate governance decisions. Adams (1999) contends that cross ownership protects the powerful position of a certain group of managers, whose power is established based on the extended ownership rights and collection of voting rights from delegating shareholders to maintain its grip on real power.

**Fifth**, cross ownership may enhance the support among partners in the ownership links but it may also lead to interdependence that hinders the driving force of development, reduces creativity and dynamism, and dislike competition. This can lead to decreased productivity, increased general costs, and the cost of production, and reduced competitiveness. Interdependence also leads to sheer inertia since suppliers are slow to improve technology and product design and quality while distributors fail to diversify the sources of supplies.

**Sixth**, cross ownership is not a measure of risk diversification to prevent from system risks. In contrast, cross ownership creates links from which specific risks can be more quickly conveyed to the system as a whole. In other words, it is hard to avoid from a chain reaction if a link of the chain is in trouble.

**Seventh**, cross ownership is likely to distort the firm values, leading to incorrect investment decisions (such as on M&A pricing). Cross ownership may also increase the virtual capital of the firm, so it is harder to assess the firm’s financial capacity. This is especially important in the finance-banking sector, because the capital requirement is the key for this activity. Virtual increases in equity make the safety ratios calculated based on equity – such as CAR or the maximum loan to equity ratio for a certain customer – become invalid.36

**Eighth**, cross ownership creates direct and indirect complex cross ownership matrices, as shown in Section 2.2.3. Meanwhile, the control right of a shareholder (or a group of shareholders) is not only her/his direct ownership right in the firm but also the indirect ownership right that created by cross ownership relations. Then, the distribution of voting power in the firm becomes unfair, breaking the one-share-one-vote rule. Losses usually fall to minor shareholders because provisions on ownership limits or voting as stipulated in the law or in the firm’s charter become useless.

**Ninth**, maintaining cross ownership requires maintaining ownership rights. Therefore, shares are often held for a long time and rarely traded, or if any, traded as a package placement rather than a public offer with dispersed values. In this case, not only the liquidity of the stock is reduced but also

large trading volumes often lead to disturbances in the market, being a tool of manipulation and having negative impacts on the securities market. However, long-term shareholdings can bring about certain benefits, such as stability in organization and governance and/or banks and firms being able to pursue long term business strategies. This is the case of Germany (see Section 2.3.4).

In short, this section analyzes some benefits and risks of cross ownership. Cross ownership exists on the grounds of benefits it creates for entities who take part in the ownership chain, while it may induce risks and costs in terms of the financial instability to the economy. Impacts of cross ownership on the economy vary depending on the extent, scope and properties of cross ownership as well as the environment in which it exists. For the financial-banking sector, due to the distinctions of the industry and experiences drawn from financial-banking collapses in the history, regulatory agencies often develop and impose a banking supervisory standard framework to build a financial-banking system that operates efficiently, safely, and properly. However, for banks, complying with regulations entails the costs of compliance and restricts the banks’ profit seeking activities, so banks often try to avoid from compliance. Non-compliance benefits the bank and shareholders who take control of it, but it does not necessarily benefit the banking system and the economy as a whole. In this case, it is justifiable for the government to step in once the financial system is at risk or the general benefit of the economy is affected. However, it is not necessary to totally eliminate cross ownership, because it is costly and inefficient; rather, the challenge is how to create the governance and regulatory environment to balance the risks and benefits resulting from cross ownership.

2.2.4.3. Identification and measurement of overlapping ownership and the ultimate owner problem

As defined in Sections 2.2.1. and 2.2.3., overlapping ownership has various properties and levels from simple to complicated. Individual and institutional shareholdings are always recorded and updated in shareholder books of the firms.

Table 2.1. Control rights in East Asian firms

<table>
<thead>
<tr>
<th>Country</th>
<th>Number of firms</th>
<th>Public ownership</th>
<th>Family ownership</th>
<th>Government ownership</th>
<th>Ownership by financial institutions</th>
<th>Ownership by public corporations</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hong Kong</td>
<td>330</td>
<td>0.6</td>
<td>64.7</td>
<td>3.7</td>
<td>7.1</td>
<td>23.9</td>
</tr>
<tr>
<td>Indonesia</td>
<td>178</td>
<td>0.6</td>
<td>68.6</td>
<td>10.2</td>
<td>3.8</td>
<td>16.8</td>
</tr>
<tr>
<td>Japan</td>
<td>1,240</td>
<td>42</td>
<td>13.1</td>
<td>1.1</td>
<td>38.5</td>
<td>5.3</td>
</tr>
<tr>
<td>Korea</td>
<td>345</td>
<td>14.3</td>
<td>67.9</td>
<td>5.1</td>
<td>3.5</td>
<td>9.2</td>
</tr>
<tr>
<td>Malaysia</td>
<td>238</td>
<td>1</td>
<td>57.5</td>
<td>18.2</td>
<td>12.1</td>
<td>11.2</td>
</tr>
<tr>
<td>Philippines</td>
<td>120</td>
<td>1.7</td>
<td>42.1</td>
<td>3.6</td>
<td>16.8</td>
<td>35.9</td>
</tr>
</tbody>
</table>

See Onetti and Posini 2009 for Germany.
Cross Ownership of Financial Institutions and Corporations in Vietnam

<table>
<thead>
<tr>
<th>Country</th>
<th>Ownership</th>
<th>Strangely</th>
<th>Strategic</th>
<th>Major</th>
<th>Other</th>
<th>Minority</th>
</tr>
</thead>
<tbody>
<tr>
<td>Singapore</td>
<td>221</td>
<td>1.4</td>
<td>52</td>
<td>23.6</td>
<td>10.8</td>
<td>12.2</td>
</tr>
<tr>
<td>Taiwan</td>
<td>141</td>
<td>2.9</td>
<td>65.6</td>
<td>3</td>
<td>10.4</td>
<td>18.1</td>
</tr>
<tr>
<td>Thailand</td>
<td>167</td>
<td>2.2</td>
<td>56.5</td>
<td>7.5</td>
<td>12.8</td>
<td>21.1</td>
</tr>
</tbody>
</table>

Ownership threshold 20%

<table>
<thead>
<tr>
<th>Country</th>
<th>Ownership</th>
<th>Strangely</th>
<th>Strategic</th>
<th>Major</th>
<th>Other</th>
<th>Minority</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td>330</td>
<td>7</td>
<td>66.7</td>
<td>1.4</td>
<td>5.2</td>
<td>19.8</td>
</tr>
<tr>
<td>Indonesia</td>
<td>178</td>
<td>5.1</td>
<td>71.5</td>
<td>8.2</td>
<td>2</td>
<td>13.2</td>
</tr>
<tr>
<td>Japan</td>
<td>1,240</td>
<td>79.8</td>
<td>9.7</td>
<td>0.8</td>
<td>6.5</td>
<td>3.2</td>
</tr>
<tr>
<td>Korea</td>
<td>345</td>
<td>43.2</td>
<td>48.4</td>
<td>1.6</td>
<td>0.7</td>
<td>6.1</td>
</tr>
<tr>
<td>Malaysia</td>
<td>238</td>
<td>10.3</td>
<td>67.2</td>
<td>13.4</td>
<td>2.3</td>
<td>6.7</td>
</tr>
<tr>
<td>Philippines</td>
<td>120</td>
<td>19.2</td>
<td>44.6</td>
<td>2.1</td>
<td>7.5</td>
<td>26.7</td>
</tr>
<tr>
<td>Singapore</td>
<td>221</td>
<td>5.4</td>
<td>55.4</td>
<td>23.5</td>
<td>4.1</td>
<td>11.5</td>
</tr>
<tr>
<td>Taiwan</td>
<td>141</td>
<td>26.2</td>
<td>48.2</td>
<td>2.8</td>
<td>5.3</td>
<td>17.4</td>
</tr>
<tr>
<td>Thailand</td>
<td>167</td>
<td>6.6</td>
<td>61.6</td>
<td>8</td>
<td>8.6</td>
<td>15.3</td>
</tr>
</tbody>
</table>

Source: Claessens et al. (2000).

For public corporations or listed firms, the list of shareholders, especially major shareholders, have to be published. The firms’ annual reports or disclosures are also required to publish the list of major or strategic shareholders, and even those who can influence the firms’ managerial and financial decisions. For minor shareholders and those who have floating transactions, their ownership rights are recorded in the notes of trading via their accounts managed by securities companies or the securities custody center. Regulatory authorities, such as State Securities Commission of Vietnam (SSC), are entitled to have access to or require for reports on the ownership of the listed firms. However, for unlisted, non-public firms or those who have no share issue, SSC is not able or hard to capture their lists of shareholders. In this cases, the tax authorities are in a better position to have access to ownership, or even financial information of firms.

For firms operating in the financial sector, such as banks or finance companies, the central bank is entitled to directly supervise and have access to their financial statements and ownership information. However, there are some obstacles that make it hard to identify and oversee the ownership status in banks or finance companies. First, it is the complexity of the overlapping ownership as above discussed. Second, shadow ownership makes it hard or non-sense to require legally for reports on the ownership status. Thirdly, the central bank is often not authorized to supervise the non-financial sector, such as firms that own banks. The third obstacle can be overcome if the central bank is authorized to oversee and govern firms that own banks, require for their reports and compliance with safety standards in relation to banks owned by them. Meanwhile, the first and second obstacles come from legally unclear or deficient definitions of ownership, its limits, the
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protection of ownership of shareholders, especially the minor, the bindingness of the rights, and the right to distribute risks and benefits of major shareholders.

It is hard to identify overlapping ownership, and even harder to measure its level or the ownership rights or actual control rights of major and shadow shareholders both in theory and in practice. Claessens et al. (2000) suggest that the presence of cross ownership entails some difficulties in measurement of cash flows and voting rights. Imagine the simplest case of cross ownership, in which Firm A owns 50% of Firm B that in turn owns 25% of Firm A. Which firm actually owns which firm in this case? What is the ownership ratio? What is the net ownership ratio between A and B? More importantly in terms of governance, who is the ultimate owner in this mutual, circular, or network relationship? Answering this question is the objective of a lot of recent research on the separation of ownership and control, and the ultimate owner problem in firms. There are some approaches to answering these questions, such as the power index method suggested by Banzhaf (1965) or the input-output algebraic matrix method. It is interesting and meaningful to approach toward this direction, but this study does not follow it due to the objectives and scope of the study.

As above analyzed, it is hard to determine where it begins and ends in a cross ownership matrix. However, in this complex matrix, more often than not some major shareholder(s) who is (are) called the ultimate owner(s) actually plays the dominant role in the firm(s) within the ownership chain. In 1932, Adolph Berle and Gardiner Means, in The Modern Corporation and Private Property, noted the prevalence of many American firms where the ownership rights are distributed to many minor shareholders but the control rights are concentrated on a few people, mostly managers. This is the agency problem as discussed in Section 2.1. Due to this problem, the ownership rights of shareholders in fact are ineffective; only the control rights count. Those who take the control rights are the real owners, regardless of their nominal shareholdings. To determine the actual ownership rights of major shareholders, La Porta et al. (1999) conduct a survey of the control chains in 30 firms in each of 27 developed economies. The research found that, except for a few economies with the good protection of shareholder rights, few firms are widely owned. Instead, firms are controlled by families and the governments. La Porta et al. (1999) identified not only those who ultimately take control of firms but also how they can do so in excess of their nominal ownership rights and neutralize the one-share-one-vote rule via pyramidal and cross ownerships. La Porta et al. (1998) also found that despite the concentration of ownership in Asian firms, they are not significantly different from those in other countries of the same level of economic development and institutional conditions. Claessens et al.

40 It is useful to distinguish between control rights and management rights although the managers in question here take control of the firms. Management rights held by managers, who may be hired based on employment contracts and not necessarily are the firm owners. Control rights are held by some shareholders, usually the major, who can determine the “life” of the firm. The ownership rights are usually represented by the control rights but the problem here is the separation of ownership and control.
also conducted a similar survey in 2,980 listed firms in 9 East Asian countries (see Table 2.1.) and found out a remarkable discrepancy of ownership and control, allowing a few families to take control of firms that account for a large capitalization in the securities markets.

### 2.3. Overlapping ownership as experienced by other countries

Studies by La Porta et al. (1999) and Classens et al. (2000) indicate that the use of pyramidal and cross ownership structures to capture power is quite prevalent in the world. In this paper, we introduce experiences from Japan, Germany, Italy, and China, where overlapping ownership structures are related to the banking system and the state ownership.

#### 2.3.1. Cross ownership in Japan

Among critical distinctions of the economic miracle in Japan during 1950-1970 are the sustainable links of economic groups, aka Keiretsu, and banks, aka Main banks. In other words, it was very common that firms set up close affiliation and cooperation with banks during 1950-1970; this not only contributed to the success of the industrialization policy in Japan, leading to the rapid growth that is called “Japanese miracle” but also constituted a distinction of its financial-economic system.

To carry out industry policies, the Japanese government not only adopted a lot preferences and direct supports to firms but also created many incentives for the bank funds to flow into manufacturing sector. Forms of joint ownership or cross ownership between industrial groups and banks were set up and getting more common. Most of mutual shareholdings among Japanese firms occurred in groups of affiliated firms with a bank, the Main bank, at the center.

From the second half of 1970s to 1990s, the Japanese economy failed to maintain the high growth momentum like the last two decades. The collapse of property price bubbles during 1986-1991 totally terminated the so-called Japanese Miracle to enter into the Lost Decade. Not only the banking system but also the production sector including the manufacturing was heavily hit by the asset price bubble burst. The interdependence resulting from cross ownership, and hence, the governance and financial interdependence, led to the dual difficulties – both in the production (the real economy) and financial sector (the monetary economy) – in Japan.

Cross shareholding among banks and economic groups used to be pervasive became a big concern in 1990s. Part of the story was in the weaknesses of capital and financial capacities of Japanese banks, because most of them relied on the market values of stocks in their portfolios to comply with capital adequacy regulations. When the Tokyo securities market collapsed in the early 1990s, Japanese banks faced difficulties in maintaining their capital adequacy as required by Basel Standards to secure their international banking activities, not to say they had to make up for their capital losses due to high NPLs. By the mid-1990s, cross ownership seemed to reduce as directly observed, but this was not assured by data (Scher 2001). Whether it reduced or not, some analyses suggested that cross

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43 The form of overlapping ownership, or shares mutually held by one another, is called Kabushiki Mochiai in Japanese.

44 The Japanese economy grew at 10% on average during 1950-1960, 5% during 1970s, and 4% during 1980s.
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ownership was among the factors that contributed to prolonging the financial crisis in Japan during 1990s. In the meantime, the others contended that cross ownership helped Japanese industrial groups manage risks better in the crisis context. Yet other studies raised the question of whether cross ownership had a positive impact on the stock price. In general, cross ownership in Japan can be summarized in four stages:

The early stage of forming cross ownership (1950-1960)

After the World War II, Japan began to recover its economy in the context of collapses of Zaibatsu groups. A Zaibatsu is a group, organized on the nepotistic basis, holding firms that in turn take control of other firms. The Antitrust Law in 1949 officially eliminated Zaibatsu model and addressed the diversity of corporate ownership structures. In couple with increases in individual investors’ ownership, mutual and overlapping ownerships in Japanese firms began and increasingly expanded. However, the role of individual investors was still limited; personal ownership was not stable as a psychological effect or due to less ability to hold up against macroeconomic and financial instabilities.

In 1953, the amended Antitrust Law allowed firms to invest in shares in others including banks and insurance companies. In this setting, the pre-existing Zaibatsu, such as Sumitomo, Mitsui, and Mitsubishi, started collecting stocks in the market and reorganized – through overlapping and joint ownerships – affiliated groups that had been disintegrated. This process led to the advent of a new organizational structure called Keiretsu. Keiretsu owned not only vertically affiliated firms but also banks and financial institutions. In contrast, banks and financial groups owned industrial and commercial firms. This result remarked the early stage of forming cross ownership in post-war Japan.

Rapid increases in cross ownership (1960-1970)

Rapid increases in cross ownership were promoted by collapses of stock prices in early 1960s. In this setting, to stimulate the stock market recovery, the Japanese government set up two special institutions, Japan Cooperative Securities Company and Japan Securities Holding Association. These institutions would buy stocks and resell them to affiliated firms and banks. This made cross ownership more pervasive. Also, during the same period, Japan’s accession to Organization for Economic Cooperation and Development (OECD) led to lax regulations on the capital market. This created chances for hostile takeovers, especially for foreign investors.

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48 Zaibatsu is a term referred to financial and industrial groups in Japan from the Meiji administration to the end of WWII. Zaibatsu had big influences and could control critical parts of the Japanese economy. Among them are 4 important Zaibatsu including Sumitomo, Mitsui, Mitsubishi, and Yasuda.
49 The Japan Cooperative Securities Company and Japan Securities Holding Association.
Table 2.2. Six major Keiretsu in post-war Japan

<table>
<thead>
<tr>
<th>Keiretsu</th>
<th>Bank</th>
<th>Major firms in the group</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mitsui</td>
<td>Mitsui Bank (to 1990), Sakura Bank (1990-2001), Sumitomo Mitsui Bank (2001-today)</td>
<td>Fuji Photo Film, Mitsui Real Estate, Mitsukoshi, Suntory, Toshiba, Toyota</td>
</tr>
<tr>
<td>Sumitomo</td>
<td>Sumitomo Bank (to 2001), Sumitomo Mitsui Bank (2001-today)</td>
<td>Asahi Breweries, Hanshin Railway, Keihan Railway, Mazda, Nankai Railway, NEC, Nipp Koei, Sumitomo Real Estate</td>
</tr>
<tr>
<td>Fuyo</td>
<td>Fuji Bank (to 2000), Mizuho Bank (2000-today)</td>
<td>Canon, Hitachi, Marubeni, Matsuya, Nissan, Rocoh, Tobu Railway, Yamaha</td>
</tr>
</tbody>
</table>

Source: Guo Li and Yakura Shinsuke (2009).

In this context, Japanese firms tried to protect themselves against being acquired by increasing cross ownership in others, such as that of Keiretsu and Main banks. In this Keiretsu model, there was always a bank at the center, named after the Keiretsu itself, encompassed by large industrial groups (see Table 2.2). The bank played the role of a credit provider and a financial service supplier to firms in the ownership group.

An apex of cross ownership and property price bubbles (1970-1980)

After the first oil shock 1973, raising capital via stock issues became prevalent due to risks of high leverage. At the same time, bank policies also encourage investments in corporate stocks. As a result, shareholdings in financial institutions were rapidly increasing. Banks themselves also aggressively issue new stocks to raise capital, and this in turn increased cross ownership.
Figure 2.8. Ownership relations of large banks in Japan

Note: Shareholdings are referred to direct ownership. Arrows go from the owners to the ones being owned. C and R refer to a city or a regional bank.


A setback of cross ownership (1990–today)

After the economic bubble burst in Japan in early 1990s, the stock prices plunged due to fire sales by many firms. This reduced cross ownership ratios in firms as well as between firms and banks. A wave of fire sales that was triggered off in 1993, getting stronger in 1997 and after the East Asian crisis 1997-1998 pushed Japan into a severe downturn. Cross ownership reduced in both terms of size and frequency.

The legal frameworks governing cross ownership in Japan

Japan did not impose any specific regulation to control cross ownership; Japanese policies even suggested that the government implicitly supported this tendency. However, when this status was prevalent, especially in the context of worsen economic conditions, cross ownership made it hard to control the contagion. Moreover, cross ownership, besides it positive impacts on industrial policies as above mentioned, began to reveal more risks, reduced competition and transparency, and influenced investors and minor shareholders’ benefits. Recognizing these risks, in 1981, the Japanese government issued the amended Law on Commerce with new provisions to restrict and control cross ownership in economic groups and the financial-banking sector. Two critical points involve in these reforms. First, there are provisions to restrict the shareholders’ ownership rights, especially for dominant major shareholders. Second, there are provisions to constrain the exercise of shareholders’ rights. These control limits were specified in more details in the new Law on Corporations issued in 2005. For example, a subsidiary is not allowed to hold shares in a corporation that is its parent company (Article 135, Law on Corporations of Japan).

Regarding the limits on voting rights, the Law on Corporations stipulates that shareholders have a voting right for a share they own in shareholders’ meetings (Article 308, Law on Corporations of Japan). Besides the Law on Corporations, Law on Banking and Law on Insurance Businesses have provisions to constrain dominant ownership and overlapping ownership. For example, Article 16-3, Section 1 of the Law on Banking stipulates: a bank or its subsidiary is not allowed to hold in excess of 5% of voting shares in a firm (Rule of 5%). Similarly, Article 107, Section 1 of Law on Insurance Businesses stipulates that an insurance company or its subsidiary is not allowed to hold in excess of 10% of voting shares in a firm (Rule of 10%).

2.3.2. Cross ownership in China

By the mid-1980s, the Chinese economy had still relied on state-owned enterprises (SOEs) in a central planning model. In this setting, to facilitate firms in adapting to a market economy, the Chinese government imposed a requirement for radical reforms of SOEs. During the early stage of reforms, SOEs with their state ownership status were not under the pressure of competition and always protected from other shareholders’ influences. This led to poor performance and weak management remnants. Therefore, economic reforms in China this period were associated with equitization and reforming the state economic sector, focusing on SOEs. In 1987, China began to adopt policies of encouraging diversity of corporate ownership to replace the traditional central planning regime.

The equitization of SOEs was conducted to allow expansion of shareholdings by people and investors. Under this condition, cross ownership was considered an efficient means to diversify ownership in SOEs. In couple with restructuring SOEs, the government carried out many solutions to restructuring underperforming firms by encouraging them to engage in cross shareholding with outperforming ones. As a result, many economic groups were established based on ownership, rather than business, relations. In 1994, the Law on Corporations came into effect and concretized the reform ideas of 1980s. In 2001, the government of Shenzhen proposed an idea of promoting corporate governance reform, in which forms of cross shareholding were encouraged.

This general trend continued after China’s accession to WTO in 2001. In couple with a series of policies to open to foreign investments, the M&A activities were getting more prevalent in China, creating potential opportunities for hostile takeovers. In this setting, Chinese firms had incentives to use overlapping ownership as a tool to protect themselves against being acquired. As a result, overlapping ownership became more prevalent in China. In late 2006, 178 listed companies were announced to be among 10 leading shareholders in 295 listed companies. In 2007, 78%, or 1135 firms, of 1450 listed companies hold shares in others (including listed and unlisted companies) to various extents. Overlapping ownership contributed to amplifying fluctuations in the stock market after 2006, pushing the stock index to its peak in 10/2007 and then drawing it down dramatically since then.
Controlling cross ownership in China

Today there are no specific provisions to govern cross ownership in China. Since cross ownership has both positive and negative aspects, as suggested by some Chinese scholars, it is important to handle various aspects of cross ownership in harmony, especially build legal frameworks and policies to govern and regulate ownership relations in general and cross ownership in particular.

For cross ownership with firms owned by banks, Article 43 of Law on Commercial Banking stipulates: CBs are not allowed to engage in trust investments, securities, and real estates businesses that do not serve their core business, and in non-banking financial institutions, even normal firms. These regulations are still controversial in China.

For cross ownership within corporations and groups, the most difficulty is to determine the relations of economic entities within a group in terms of not only the nominal shareholding but also the economic relations that constitute the benefit ties between them. The Law on Enterprises (Article 217) and corporate accounting principles issued by Ministry of Finance of China used the term “control” to describe the ability to take actual control of entities by investment relations, partnership agreements, economic contracts, or any other arrangements (Guo Li and Yakura Shinsuke 2009). Using the term “control” or “control right” may be more generalized than the concepts of cash flow right or ownership right, but it is more elusive and hard to measure.

For entities that are not within a group, policies of controlling cross ownership are not stringent because this ownership relation does not supposedly cause negative impacts on the firm value. However, in some necessary cases, the government can impose limits on the exercise of shareholders’ rights. Limits on shareholdings can be flexibly imposed depending on specific cases, such as 10% or 20% for listed or unlisted companies, respectively. Furthermore, accompanied with imposition of ownership limits or shareholders’ right constraints, regulations on information transparency and prevention of monopoly and privileges are strictly complied.

In short, cross ownership in China is a new and controversial problem. Some contend that cross ownership is a normal phenomenon and does not need to be dealt with, while others suggest that it is necessary to identify risks in each particular case to have governance and supervisory measures. Yet till now, China has not officially had any specific policy to deal with this.

2.3.3. Cross ownership in Italy

In early 1990s, many economic and financial reforms changed the face of Italian banking-financial sector. Many new acts on reforming financial sector in general and banking sector in particular were adopted within the general policy framework of EU after the Maastricht Treaty.54 In this setting, there were two important processes that play a central role in transforming Italian banks’ ownership structures: the government sold their shares in banks and the M&A were dramatically happening in the banking-financial sector. These processes were launched in 1993 and basically finished in 1998-

54 Maastricht Treaty on EU that led to the advent of the European Currency Unit was signed on 7/2/1992 in Maastricht, the Netherlands, and came into effect on 1/11/1993.
Decreasing state ownership in banks was mostly conducted via private placements with groups of major shareholders who play the role of controlling the Italian financial market. This process in couple with M&A related to many large Italian banks led to the fact that a limited number of shareholders take control of major shareholdings in most of Italian banking groups. This result complicated the ownership structures in general and cross ownership in particular in Italian banking system.\(^{56}\)

Regarding the impacts of cross ownership on the banking financial sector in Italy, many studies suggest that cross ownership is a reason for hampering the competitive environment and banks’ competitive capacities (Trivieri 2005).\(^{57}\) This result is relevant to research by Gilo (2000)\(^{58}\) and Gilo and Spiegel (2003)\(^{59}\), suggesting that cross ownership can reduce competition due to the collusion between firms. Maxwell et al. (1999)\(^{60}\) and O’Brien and Salop (2000)\(^{61}\) point out that when major investors own many firms in the same industry, cross ownership will change the gain from competition and shift the equilibrium point toward monopolistic policies. Some authors such as Messori (1999)\(^{62}\), and Inzerillo and Messori (2000)\(^{63}\) contend that it is necessary to have solution initiatives to disaggregate the labyrinth of cross ownerships in Italian banking system to create a more competitive market for banks, and hence, improve the results of restructuring the Italian banking sector that is assessed to be weak compared with that of Germany, or U.K., or France.

\(^{55}\) In late 2001, government ownership in Italian banks was only 0.1%.

\(^{56}\) See Inzerillo and Messori (2000) for privatization and M&A, and the roles of these processes in forming overlapping ownership in Italian banking system.


Table 2.3. Cross ownership in Italian banking system (31/12/2000)

<table>
<thead>
<tr>
<th>Banking group</th>
<th>Owner 1</th>
<th>Owner 2</th>
<th>Owner 3</th>
<th>Owner 4</th>
<th>Owner 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>UNICREDIT</td>
<td>6.054</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SAN PAOLO IMB-BANCO DINOPOLE</td>
<td>4.909</td>
<td>3.00</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BANCA DI ROMA-ACC</td>
<td>2.109</td>
<td>10.05</td>
<td>10.209</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BANCA MPS</td>
<td>2.008</td>
<td>7.620</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BANCA NAZIONALE DEL LAVORO</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BANCA CARDINE</td>
<td>1.500</td>
<td>6.290</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BANCA LOMBARDA E.P.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CARNOARD</td>
<td>3.100</td>
<td>19.059</td>
<td>44.97%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>CREDEM</td>
<td>2.057</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Note:** All the figures are in percentage terms. Symbol (†) denotes that the banking group was not quoted on the Italian Stock Exchange on 31.12.2000. Symbol (§) denotes a majority ownership share.

- a Mediobanca has 100% shareholding
- b Mediobanca has a large part of shareholding (14.53% directly and 4.35% via Spafid.)
- c Mediobanca has a large part of shareholding (10.09% directly and 5.15% via Spafid.)

**Source:** CONSOCB and Il Sole 24 Ore. Trivieri (2005).

### 2.3.4. Cross ownership in Germany

The financial system in Germany mainly relies on banks like in Japan, while the German securities market does not play an important role as it does in the Anglo-Saxon financial system.\(^64\) The average market capitalization in Germany was only 38% during 1990-2005, while it was 113% and 132% in the U.S. and U.K., respectively. While banks play a critical role, the bank-firm connections supposedly contributed to the successful industrialization in Germany and create the distinction of the so-called German-style financial capitalism (Gerschenkron 1968).\(^65\) Bank-bank, bank-firm, and firm-firm cross shareholdings in Germany often have a stable long-term tendency.\(^66\) Some researchers call this distinction of German financial model “the permanent owner”.\(^67\)

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\(^64\) The Anglo-Saxons were a people who inhabited Great Britain from the 5th century. They included people from Germanic tribes who migrated to the southern half of the island from continental Europe, and their descendants; as well as indigenous Romano-British populations who adopted Anglo-Saxon culture and language. The Anglo-Saxon period denotes the period of British history after their initial settlement, until the Norman Conquest, between about 450 and 1066 (Wikipedia).


\(^66\) In the U.S. and U.K., banks usually do not hold long-term portfolios in non-financial companies (see Berlin 2000). In France, most of existing investments have been made in 1980s and 1990s based on the privatization during this period (see Magnani 1999). In Italy, banks had not been allowed to hold portfolios in non-financial companies until 1991, when the Legge-Amato-Carli Law was promulgated.

\(^67\) Porter (1992) used the terms “permanent owner” and “dedicated capital” to distinguish from the Anglo-Saxon model of “fluid” and “transient” owner/capital.
Figure 2.9. Ownership structure of DEPFA AG.


Large banks' cross ownership with insurance companies in Germany has been set up very early since the late 19th century. Experimental studies suggest that cross ownership and concentrated shareholdings were more pervasive in established firms, but tended to reduce in 1990s and especially during period of information technology development (Andreani 2003).68

68 It is noteworthy that most of large firms in Germany share the human resource, such as Allianz set up in 1890 by Carl von Thieme, the former CEO of Münchener Rück Versicherung, and the banker, Wihelm von Finck. Similarly, one of the founders of Deutsche Bank was Georg von Siemens, who was also the founder of Siemens.
Some research suggests that the abuse of cross ownership is among the reasons for the undedevelopment of financial markets (Gorton et al. 2002). The German law governs the cross ownership only in case two firms own more than 25% of shareholdings in one another. However, according to Andreani (2003), 25% in fact is more than enough and so easy for two shareholders to collusively control the others.

The German Law on Banking allows banks to hold shares in industrial firms. This shareholding help banks have influences on the firm governance and decisions. The bank-firm relations in Germany are often stable in the long term with high levels of ownership concentration (Charkham 1989). In this ownership structure, a bank is usually responsible for meeting most of, or even all of, financial demands by firms, which in turn use only financial services delivered by this bank. This model is as sames as the main bank model in Japan as above mentioned and called Hausbank. However, it does not mean that each firm has ownership or business relation with only one bank; rather, the Hausbank plays a more important role than the others. In other words, a main bank provides most of funds, including debt and equity, and delivers financial services to firms. In doing so, the bank can intrude into the firms’ activities through decisions by the board of management. In contrast, when firms are in financial distress, they rely on the main bank’s support. Since other financial sources are not available or underdeveloped due to the small size of the capital market, for instance, firms tend to rely on the main bank, and hence, the costs of bailing out industries are often put on the main banks. As a result of this dependence, banks ultimately take over or have large shareholdings in industries. However, banks ussually do not resell these shares after the firm recovery; rather, they go on holding them to keep on their influences on the firm governance and operations (Andreani 2003).

It is interesting that German banks can influence firms not only directly but also via proxy vote; that is, they can exercise the voting rights of shareholdings by their retail customers. Experimental studies by Baums and Fraune (1994) and Gottschalk (1988) suggest that banks can exercise their proxy voting rights up to 60% in addition to their own direct or indirect shareholdings up to 25% in manufacturing firms. This makes German banks have great power over manufacturing firms, and in some cases, the voting rights of banks are up to 90% (such as Basf and Bayer), or even 95% in public corporations (such as Siemens, Hoechst, and Mannesmann).

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70 See also Appendix 5 for the differences between the U.S.-U.K.-style and German-Japanese-style financial systems.
71 Aka the Hausbank Model.
A body of literature suggests that the tendency of long-term shareholding helps create the stability in ownership structure, governance, and strategic planning not only in German banks but also in its manufacturing firms. This tendency also help banks, insurance companies, and manufacturing firms limit the threaten of hostile takeovers. This is proved by the fact that there were only three acquisitions from WWII to the late 1990s with the well-known Mannesmann - Vodafone deal (in 1999/2000) and only one being successful. Cross ownership leads to a governance and control system mainstreamed in many firms and banks where there are the same board members. This mainstreamed system is characterized by extremely close relations and interdependence among members of BOM of various firms, and hence, the resulting stable internal relations and shared strategies (Hopt et al. 1998). In effect, the fact that a firm nominates their board members to the boards of supervisors (BOS) of other firms without certain shareholdings, has become commonplace in Germany.


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73 Hoesch was successfully acquired by Krupp AG in 1995/1996. The two failed deals were Veba AG trying to take over Feldmule AG in 1989, and Continental AG trying to fight against acquisition effort by Pirelli in 1990/1991 (recited from Andreani 2003).

However, since the late 1990s, many new factors have significantly changed the traditional financial model in Germany.\textsuperscript{75} The research by Onetti and Pisoni (2009) pointed out important changes that altered the traditional financial pattern in Germany. The first is rapid increases in internationalization activities by German firms initiated since the early 1990s. The second is increases in foreign direct investment in German firms.\textsuperscript{76} The third is a change in the banks’ perspective toward economic activities. Internationalization of financial markets has put German banks in a competitive environment with others, including foreign banks, for raising capital. In this setting, banks have to meet the investors’ expectations of creating values even in the short term. This discourages banks from pursuing long-term values, such as holding long-term portfolios in manufacturing firms as previously. Forth, increased bankruptcies has changed the ownership and governance pattern in many German banks in the early 2000s. Fifth, the increasing role of the securities market has increased chances for many firms to have access to capital, changed the negotiation power, and decreased their dependence on bank loans. Sixth, banks tend to reduce their shareholdings in manufacturing firms due to their strategies of repositioning business operations toward investment banking and asset management. This trend is supported by the government’s tax reform policies.\textsuperscript{77} Seventh, legal system reforms, such as the Law on Corporate Control and Transparency passed in 5/1998 addressing improvements in the investors’ positions by requiring firms to provide more information on their operations and governance. Also, the law requires banks that have more than 5% of voting rights in unlisted firms or engage in their underwriting syndicates announce how they exercise their voting rights to their clients. Another significant change is that banks are not allowed to exercise the voting rights in the name of their depositors in firms in which banks have more than 5% of shareholdings except when they get specific instructions from their clients or they give up their own voting rights. In addition, new regulations on corporate governance coming into effect in 2/2002 in Germany limit the nomination of bank representatives to the BOS of firms in which banks have shareholdings. Accordingly, a person is not allowed to hold more than 5 positions, in stead of 10 positions as before, in the listed firms’ BOS.

\textsuperscript{75} It is noteworthy that the changing traditional role of German banks mostly relates to large non-financial companies in which banks have become providers of financial services. Meanwhile, for small firms, the traditional role of banks remains unchanged.

\textsuperscript{76} As the case of Vodafone Air Touch acquiring Mannesmann in 1999/2000 as above cited.

\textsuperscript{77} In 2000, the Schröder administration adopted the tax reform policy that reduced tax on securities trading, such as to 25% for retained earnings (from 40%) and distributed profits (from 30%), and removed tax on capital gain from equity of corporate investments in other domestic corporations.
Figure 2.11. Cross ownership in the top ten of German firms


Besides the above countries, many nations establish caps on overlapping ownership in various ways. For example in France, shareholding and exercising the voting rights between two joint-stock companies are limited at 10% while not absolutely prohibited. However, if a firm is not a joint-stock company (JSC), cross ownership will not be allowed; in contrast, if both firms are not JSCs, cross ownership will be acceptable. In the U.S., overlapping ownership in general is not forbidden, but the exercise of vertically cross ownership is limited. Previously, the Glass-Steagall Act prohibited banks from carrying out business and investing activities and shareholding in other entities. Although this Act was ruled out in 1999, restrictions are still effective for CBs that have shareholdings in non-financial companies. Thus, banks have few incentives to hold shares in other firms for the purpose of cross ownership (Cara Lown et al. 2000)⁷⁸. In U.K., vertically cross ownership, i.e. shareholding within groups, is generally forbidden.

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CHAPTER 3
OWNERSHIP STRUCTURES OF FINANCIAL INSTITUTIONS IN VIETNAM: STATE OF AFFAIRS AND POLICY ISSUES

3.1. The status of overlapping ownership in financial institutions

3.1.1. Overlapping ownership in SOCBs

Except Agribank, the other SOCBs have gone public with the state’s shareholdings being 77.1% in Vietcombank (VCB), 60.3% in Vietinbank, and 95.8% in BIDV. Mekong Housing Bank (MHB), due to not completing the post-IPO registration procedures, has not really become a JSCB. Figure 3.1 presents the overlapping ownership of SOCBs as updated in 5/2012.

As the first SOCB to go public, Vietcombank currently has 4.37% shareholding in Saigon Bank for Industry and Trade (Saigon Bank), 8.2% in Vietnam Import Export Bank (Eximbank), 9.67% in Military Bank (MB), and 5.1% in Orient Commercial Bank (OCB). By 2010, Vietcombank had sold out its 50% shareholding in ShinhanVina JVCB. In general, shareholdings by Vietcombank in these banks have been more or less reduced from those of one year ago but still significant. Vietcombank is still a major shareholder, and hence, can directly dominate the governance and operations in these banks.

Figure 3.1. Ownership structure of SOCBs (updated in 4/2013)

Source: Complied by FETP Research Group from the banks’ annual reports and governance reports.

In Saigon Bank that mainly owned by HCMC Committee of Party, besides Vietcombank, Vietinbank has 9.14% shareholding. This ratio has been mildly reduced from 11% one year ago but still significant. In addition, Vietinbank has 50% of capital in Indovina JVCB. Similarly, BIDV has shareholdings in the three JVCBs: 50% in VID Public, 50% in Lao-Viet Bank, and 51% in Vietnam-Russia Bank. Meanwhile, Agribank has 15% shareholding in Maritime Bank (MSB) via Agribank Securities Company (Agriseco) in addition to 34% shareholding in Vinasiam JVCB.
Figure 3.2. Ownership structure of SOCBs (updated in 10/2013)

Source: Complied by FETP Research Group from the banks’ annual reports and governance reports.

While SOCBs have shareholding in a few JSCBs or JV CBs, some SOCBs themselves are partly owned by foreign investors. Most of investors holding shares in SOCBs are strategic investors. For example, Mizuho has 15% shareholding in Vietcombank; Tokyo-Mitsubishi and International Finance Company (IFC) have 19.73% and 10% shareholdings, respectively, in Vietinbank; while BIDV has not had strategic investors yet. This seemingly suggests that the target of attracting strategic investors when SOCBs go public has been fulfilled though not very successfully. However, this is only the first step; a more important question is whether these strategic investors can actually exert their role and capabilities under the condition of almost absolutely dominant shareholdings by the state in SOCBs.

In general, overlapping ownership in SOCBs now is basically pyramidal ownership and not too much complicated. SOCBs have shareholdings in just a few JSCBs or JV CBs and some SOCBs are owned by foreign banks. The fact that some SOCBs engage in holding shares in JSCBs is partly due to historical reasons, namely, the government may use a SOCB to bail out a JSCB in difficulty, such as the case of Vietcombank that has shareholding in Eximbank. However, in other cases, the SOCBs themselves aggressively own JSCBs. Although overlapping ownership in SOCBs has just started and not much complex, taking into account the cross shareholdings amongst JSCBs that are held by SOCBs complicates the picture of cross ownership.

The critical point here (to be analyzed in Section 0) is that the State plays the role of both the (main) owner of SOCBs and the supervisor of banking regulations, and hence, the compliance is very lax, even a few exceptions have been applied for these SOCBs, resulting in the moral hazard that endangers the financial system as a whole. More often than not credits are favorably extended with easier terms and conditions to SOEs than others. The reality shows that the debt balances extended by SOCBs to SOEs are always kept at a very high level of 50-70% of total credit balance, while the role and contribution by SOEs to the entire economy are diminishing. The government usually directs SOCBs to extend credits to SOEs while ignoring the credit limits and conditions as required by the SBV.79 Such directed credit policies establish bad precedents against the serious compliance with

79 Such as a loan to Huwię Quảng Hydropower Plant of EVN as illustrated in Figure 3.15.
regulations and create a moral hazard in banks themselves. For directed credits, while the government does not have its own supervisory agency, banks do not have incentives to oversee firms, which in turn have no incentives to oversee themselves. Thus, all risks are put on the government while the burden of debt is put on the state budget. With pyramidal ownership, it is useful to note that the government also owns JSCBs indirectly via SOCBs. When SOCBs has dominant ownership rights in JSCBs, the agency problem arises in JSCBs as it does in SOCBs. JSCBs are also manipulated to engage in financing projects directed by the government. This may be opportunities for JSCBs to have access to the large efficient public projects, but if this is a directed credit, the financial risk to JSCB may be put on either the remaining private shareholders or the State.

Figure 3.3. Neutralization of supervisory system when the State is the owner of banks and firms

As illustrated in Figure 3.3, when the State is both the owner of banks and firms and the financial supervisor, safe banking regulations are likely to be neutralized. Moreover, as explained in Section 2.1, from the point of view of the agency cost theory, managers of SOCBs have few incentives to exert their best efforts; rather, they have incentives to divert resources toward their own interests, both economic and political. From the point of view of the state ownership, SOCBs are not efficient because the purposeful policies of politicians aims at transferring resources to uphold their own political positions (Shleifer, 1998). Maintaining state ownership in SOCBs delays intensive reforms in the financial system and increases the monitoring cost and the agency cost.

3.1.2. Overlapping ownership among SOEs and CBs

The analysis in Section 0 points out a tie between SOEs and SOCBs that share the state ownership. Thanks to this tie, many SOEs find it easy to have access to bank credits. CBs themselves favorably extend credits to SOEs, perhaps because banks contend that SOEs are bailed out (maybe implicitly) by the government, or because the government directs them to do so, or they want to solicit the huge deposits from SOEs. Directed credits used to be a reason for increased obligations borne to the state budget and the government has gradually reduced directed credit interventions by tightening guarantee terms and conditions. It is right and necessary for the government to do so, though, there are rooms to tighten further the guarantee conditions toward a definite end of directed credits. While the government has tried to tighten guarantee conditions, however, SOEs have found other ways to connect with JSCBs for recent years.
Figure 3.5 presents the overlapping ownership among SOEs and CBs. It indicates that most of large SOEs own banks. For example, Military Bank is owned by state-owned institutional shareholders including Viettel Telecom Group (10%), Saigon Newport (5.7%), and Vietnam Helicopter Corporation (7.2%). Maritime Bank is owned by Agribank (15%), Vinalines (5.3%), and VNPT (12.5%). Also, VNPT has 6% shareholding in Lien Viet Post Bank (LVB) and 6.1% in SeABank. Figure 3.5 also points out that PetroVietnam holds shares (20%) in Ocean Bank. Vietnam National Coal Mineral Holding Corp. (TKV) and Vietnam Rubber Group have 9.3% shareholding each in SHBank, while Vinatext owns 13.2% of Navibank. Vietnam Electricity (EVN) has 25.4% shareholding in An Binh Bank (ABB). Bao Viet Group has 52% dominant shareholding in Bao Viet Bank. Similarly, Petrolimex has 40% shareholding in Petrolimex Group Bank (PG Bank).

Not only the government owns SOCBs and SOEs own JSCBs, but also local authorities engage in bank shareholding. Figure 3.4 indicates that Party Agencies or People’s Committee of HCMC also directly or indirectly owns banks. The figure shows four CBs including VietABank, OCB, DongA Bank (EAB), and Saigonbank (SGB) owned by HCMC Committee of the Party. HCMC Committee of the Party and affiliated firms directly have huge, even dominant, shareholdings in these banks, such as 63.6% in SGB and 15.3% in OCB. Some SOEs set up by the city government or gone public, such as PNJ and SJC\(^8\), have large shareholdings in these banks. In addition, other SOCBs, such as Vietcombank and Vietinbank, also have shareholdings in banks that owned by the city government. Figure 3.4 has even not revealed the private ownership of some leaders of SOEs owned by the city government who were or are the representatives of the state capital in these firms. Taking into account the private ownership of SOEs leaders certainly complicates the overlapping ownership matrix of banks that owned by the city government.

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\(^8\) PNJ was set up in 1988 under the name of Phu Nhuan Jewelry Shop as a subunit of People’s Committee of Phu Nhuan District. In 1994, it was transferred to Finance Management Board, HCMC Committee of the Party. In 2004, PNJ went public and became a joint-stock company. Similarly, SJC has a history like PNJ in the light of Decision 180/QĐ-UB dated 17/09/1988 by People’s Committee of HCMC.
Figure 3.4. HCMC Committee of the Party and People’s Committee of HCMC own commercial banks (as of 5/2012)

Source: Complied by FETP Research Group from the banks’ annual reports and governance reports.
3.1.3. Overlapping ownership amongst banks and between them and firms

Figure 3.5 also illustrates the overlapping ownership amongst banks and between non-state firms and banks. For example, in addition to 8.9% shareholding in MB, MSB has 11.2% shareholding in MD Bank. Also, Techcombank is owned by Masan Group (7.2%), Eurowindow (19.7%), and HSBC (19.6%). Both Navibank and Western Bank are owned by Saigon Binh Dinh Energy JSC. DaiA Bank is owned by Tin Nghia Group (14.4%) and Dong Nai Lottery Company (5.8%).
Compared with SOCBs, ownership structures in JSCBs are more complicated, and hence, it is hard to trace their ultimate owners. In JSCBs, the ownership structures of Eximbank, Sacombank (STB), and ACB are of the most complicated. Figure 3.6 illustrates that ACB, Eximbank, and SouthernBank own STB via affiliated firms. ACB, Eximbank and STB are the leading listed JSCBs that are supposedly transparent.

**Figure 3.6. Overlapping ownership amongst ACB, Eximbank, Sacombank, and some small JSCBs (5/2012)**

Eximbank, via Saigon Exim Investment JSC, has 5.2% shareholding in STB. Likewise, SouthernBank owns Sacombank through its affiliated companies, Phuong Nam Securities Corp. and Phuong Nam Jewelry Commercial Corp. More complicatedly, ACB has 5% shareholding in STB through Saigon A Chau Finance Investment JSC. In addition, ACB owns 20% of Eximbank and many other JSCBs such as VietBank (10%), DaiA Bank (10.8%), and KienLong Bank (6.1%), via ACB Securities Company (ACBS).

*Source:* Complied by FETP Research Group from the banks’ annual reports and governance reports.
Figure 3.7. The role of some individuals in taking over and shaping the ownership structure of STB (6/2013)

Note:

(1) Used to be BOM Chairman of SouthernBank.
(2) Used to be BOM Chairman of Phuong Nam Securities Corp., transferred to another dominant shareholder since 4/2/2013.
(3) Transferred all 6.62% shareholding in Phuong Nam Securities Corp. to another dominant shareholder.
(4) BOM member in Sacombank.
(5) Being the representative of Saigon Exim Finance Investment JSC in Sacombank.
(6) Used to be the Vice Chairman of Vietcapital Securities Company.
(7) BOM Chairman and Vice Director of Vietcapital Bank.
(8) Used to be Vice Director of KienLong Bank.
(*) Chief accountant of ACB.
(**) Used to be represented by a dominant shareholder (BOM Chairman)

Source: Complied by FETP Research Group from the banks’ annual reports and governance reports and other sources such as Cafef.vn, Gafin.vn.

The recent acquisition of STB suggests that behind it are some individuals who play a very important role in shaping the bank ownership structure (see Figure 3.7). Although it is not clear if they are ultimate owners, these individuals have huge powers in banks. With them (or themselves), the ultimate owners can have control rights in banks even if their ownership rights are very few. In other
words, there are signs of a separation of control and ownership in Vietnamese CBs, making it hard to supervise them.

Overlapping ownership in banks as illustrated in Figure 3.6 reveals the presence of the so-called finance investment joint-stock companies (JSC), such as Saigon-Exim Finance Investment JSC, Saigon A Chau Finance Investment JSC. Firms of this sort are set up for the purpose of making financial investments and governed by the Law on Enterprises (2005). However, their operations by nature are like those of financial investment funds. While the establishment and operations of financial investment funds are governed and regulated by State Securities Commission (SSC), these firms are governed by the Law on Enterprises and not regulated by SSC. Having shareholding in banks, they are not required to comply with supervisory regulations of SBV and report to regulatory authorities.

In short, the status of overlapping ownership amongst banks and between firms and banks is very complicated. Presumably, thanks to overlapping ownership, CBs can loophole the supervisory framework of SBV, and to a certain extent, make banking regulations ineffective. The following section analyzes the ownership structure characteristics of the banking sector in Vietnam and points out why overlapping ownership is used and leads to a lot of negative impacts on the compliance with safe banking regulations of SBV.

3.2. The ownership structure characteristics of the Vietnamese banking sector

Empowering the theoretical framework in Chapter 2 in the ownership picture as shown in Section 3.1, one can see four main characteristics of the ownership structure in the banking sector.

The first is the separation of control and ownership rights by using pyramidal, cross, and overlapping ownership structures. Except five SOCBs, most of the remaining banks are characterized by pyramidal and overlapping ownership structures through other banks, non-banking financial institutions, state-owned or private groups as intermediaries. The cross ownership structure as strictly defined in Section 2.2.3 is not common but does exist in some cases and complicates the overlapping ownership picture.

The second is the presence of the State – via government agencies, local governments, public organizations and personnel, especially SOCBs – in JSCBs. These entities own JSCBs both directly and indirectly via pyramidal ownership. Taking into account the indirect ownership relations as being co-owners of an intermediary JSCB, these entities have affiliated with 22/34 JSCBs. For example, Navibank at the first glance is owned by Vinatext and Gemadept. But Gemadept has shareholding in Maritime Bank, which in turn has shareholding in Military Bank, and hence, Gemadept indirectly owns Military Bank. In turn, Military Bank is directly owned by VCB and indirectly by Agribank (via Maritime Bank). Thus, VCB and Agribank, though having no shares in Navibank, are affiliated with Navibank by co-owning an intermediary JSCB with the direct owner of Navibank.

The third, a fundamental feature of overlapping ownership in Vietnam distinguished from that of Japan and Germany is the fact that economic groups and SOEs own JSCBs, but the reverse ownership

81 Saigon Exim Finance Investment JSC registers its core businesses as developing and sales of real estates, hotels, high-end resorts; consultancy, intermediary, and evaluation of real estates...
Cross Ownership of Financial Institutions and Corporations in Vietnam

does not exist, namely, CBs do not own firms. While we do not support the fact that banks own firms, this ownership has less negative consequences than it would have if firms own banks. In the overlapping ownership in Japan and Germany, a bank that owns firms usually increases its oversight duties as both a creditor and an owner over the credits extended to them. When a firm owns banks, its main benefit does not lie in increases in the stock value or the dividends paid by banks but in the exploitation of financial leverage from banks to direct the credits for the firm’s business purposes. In Vietnam, taking into account the economic groups and SOEs’ ownership leads to 29/34 JSCBs that are directly or indirectly affiliated with the public agencies/legal persons.

The fourth, a similarity between Vietnam, many East Asian countries, and some civil law countries, is the ownership concentrated in hands of groups of shareholders (individuals, families, private groups) rather than widely held as in common law countries. These groups use the piramidal and overlapping ownerships to capture powers and dominate decisions of JSCBs in the chain of ownership. Some typical examples are Sovico, Gemadept, FPT, and Asia Investment JSC.

Besides the above features, the picture of ownership in Vietnamese financial system still has some obscure points captured in the fifth feature – shadow ownership. A case study of the three bank merger (see Section 0) is a typical example of shadow ownership.

3.3. An evaluation of overlapping ownership supervision and consequences

3.3.1. State of affairs of compliance with safe banking regulations

Law on Financial Institutions of 2010 specifies 6 ratio categories to ensure safe activities in financial institutions: (i) solvency ratios; (ii) capital adequacy ratio; (iii) the maximum ratio of short-term capital used for mid- and long-term loan; (iv) foreign exchange and gold to equity position; (v) loan to deposit ratio, and (vi) ratio of mid- and long-term deposit to mid- and long-term loan balance. However, current regulations by the SBV as specified in Circular 13\(^{82}\) include only 5 categories of ratios: (i) capital adequacy ratio, (ii) credit limit, (iii) solvency ratio, (iv) limit on capital contribution and equity purchase, and (v) loan to deposit ratio.\(^{83}\) Moreover, Circular 22/2011/TT-NHNN amended Circular 13 eliminates the provision of loan to deposit ratio (v).\(^{84}\) This section shows the compliance with safe banking regulations and analyzes drawbacks of the Law on Financial Institutions and Circular 13 in effective and efficient banking supervision.

3.3.1.1. Capital adequacy ratio (CAR)

As required by Circular 13, financial institutions have to keep at least 9% CAR of equity to risky assets, including separate and consolidated CARs. CAR of 9% required by Circular 13 is beyond the 8% standard of Basel II. Although Circular 13 specifies tier-1 and tier-2 capital in details, these definitions have few meanings in application. In other words, Circular 13 does not stipulate the

\(^{82}\) It is useful to note that Circular 13/2010/TT-NHNN is issued based on the Law on Financial Institutions of 1997 and the Law on Financial Institutions Amendment of 2004. Meanwhile, the Law on Financial Institutions of 2010 promulgated later and came into effect on 01/01/2011 has more validity than Circular 13.

\(^{83}\) Provisions of Circular 13 are not applied for Vietnam Bank for Social Policies (VBSP), Vietnam Development Bank (VDB), and the local people’s credit funds.

\(^{84}\) Due to its importance, this study still discusses that provision.
specific CAR for each tier. This is different from Basel, in which tier-1 capital is required to be at least 4% by Basel II and up to 6% by Basel III, with equity at least of 2% and 4.5%, respectively. Overlooking these drawbacks, many evaluations suggest that increasing CAR is necessary and suitable to international practices to encourage banks to restructure and enhance their financial potentialities. These provisions require financial institutions review their capital and assets and accordingly raise capital or reduce loan balance and give priorities to safer assets to comply with more demanding provisions. CAR as required by Circular 13 is fundamentally different from the concept of legal capital adequacy as required by Decree 141, although both regulations address enhancement of FIs' financial capacities.

It is also noteworthy that provisions of Circular 13 do not capture the capital risks as identified. A financial institution meeting the CAR requirement by Circular 13 does not really improve its safety in its risk management and organizational structure. In other words, Circular 13 still uses the approach of Basel I, while that of Basel II captures both market and operation risks, rather than the credit risk, in the denominator of the formula. Many analyses show that while countries begin to implement new standards of Basel III, Vietnam is still away from applying those of Basel II.

To determine CAR, Circular 13 defines quite specifically items that should be excluded from tier-1 capital, such as commercial advantages, business losses, capital contributions/equity purchases in other financial institutions/subsidiaries. These provisions supposedly contribute to eliminating partly virtual equities estimated to be significant in banks.

Circular 13 also groups assets into various risk categories in more prudent manner. It is noteworthy that Circular 13 specifies very high risk up to 150% and 250% for some assets. In particular, loans to the bank’s subsidiaries, joint venture companies, and affiliated firms have 150% risk; loans to securities investments, securities companies, and real estate businesses have 250% risk. These new provisions are expected to significantly reduce CARs of many banks because they have recently allocated remarkable capital into securities and real estate businesses. However, some financial institutions regard this regulation as deficient because it equates all subjects of different risks; for example, loans with advance payment of some proceeds from sales of securities are less risky because the likelihood of credit loss is negligible. Similarly for loans to real estates, Vietnam Banks Association (VNBA) suggests that SBV should establish risk categories appropriately based on the levels of risk of real estate loans, because those classified as high risk categories increases the banks’ risky assets, while their equities remain unchanged, thus the banks’ CARs reduce significantly. Furthermore, this regulation does not separate operations of CBs and investment banks in the context in which their boundary is blurred, especially in credit extension and securities purchases.

85 Basel I was introduced in 1988, Basel II in 2004, and Basel III in 2010.
Figure 3.8. Assets and equities of financial institutions

In general, the CAR provisions are more specific and cohesive in Circular 13 than in previous Decision 457/2005/QĐ-NHNN. By 10/10/2010, the deadline of CAR requirement by Circular 13, many banks found it impossible to meet the 9% CAR requirement in time. Many analyses suggest that it is not easy to raise capital when the securities market is going down. Meanwhile, it does not make sense for a merger, because a merger of two banks of low CARs cannot arithmetically increase the CAR of the merged bank, although its charter capital increases in absolute terms. Furthermore, raising capital to increase CAR may lead to increases in total assets of FIs to meet the expected rates of return. Then the management capacities of banks may fall short, and hence, cause more operation risks.

Figure 3.9. CARs in Vietnamese banks, 2010 - 2012

In addition, some analyses contend that the time frame for implementation of Circular 13 is too short (5 months since its promulgation) for financial institutions to follow in practice, and it has a big
impact on the banks’ credit activity and triggers a race of increasing interest rates. Increasing CARs to 9% requires that financial institutions should increase equity and/or reduce risky assets, including loan balances, capital contributions and securities investments. However, raising charter capital in a short time without a plan approved by a shareholders’ meeting is impossible. Also, reducing loan balances requires time due to irrevocability of loan contracts.

In fact, facing CAR requirement, many banks engaged in disinvestment in subsidiaries and other firms and continuously announced their decreased ownership in these firms. In the mean time, other banks found it hard to comply with Circular 13 in general and CAR provision in particular. However, as reports suggested, except for Agribank (6.4%) and Vietinbank (8.02%), other banks had met, even gone beyond, the required minimum CAR. In particular, some banks have their CAR of above 30%, such as VietCapital (54.92%, 2010) and Kienlong Bank (36.16%, 2010). By the late 2012, all Vietnamese banks, including Agribank, had met the CAR requirement in Circular 13 (see Figure 3.9).

3.3.1.2. Credit limits

Circular 13 stipulates that total loan balance of a financial institution to one customer should not exceed 15% of its equity; total loan balance and guarantee balance to one customer should not exceed 25% of its equity; total loan balance to a group of affiliated customers should not exceed 50% of its equity; total loan balance and guarantee balance to a group of affiliated customers should not exceed 60% of its equity. However, according to a newer and overriding regulation, the Law on Financial Institutions, total credit balance of a financial institution to a customer should not exceed 15% of its equity; to an affiliated customer not 25% of its equity. For a non-banking financial institution, total credit balance to a customer should not exceed 25% of its equity, and to an affiliated person and customer not 50% of its equity. It is useful to note that the credit balance here includes total level of investment in bonds issued by customers but not include the loans from trust funds of the government, individuals, or institutions, or in cases customers are other financial institutions. This provision is supposed to be a reason for increases in trusted loans in recent years to loophole the SBV’s regulation on credit growth and loan limits.

For credit limits for an affiliated person and customer, it is important to identify who are affiliated persons. Circular 13 and particularly Item 8, Article 4, Law on Financial Institutions of 2010 define quite specifically affiliated persons, but some points should be explained in more details. Moreover, compared to the Law on Enterprises of 2005 and the Law on Securities of 2006 (see Box 3.1), definition

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86 For example, Vietcombank registered for sales of more than 2 million PVD stocks and 10 million EIB stocks; Sacombank successfully held IPOs of SBS and SCR, and disinvested almost half of its capital contribution in BHS... In addition, Vietcombank successfully offered 112.28 million stocks; Vietinbank offered and paid dividends to existing shareholders with 392 million stocks; Sacombank issued 134 million STB stocks; SHB raised capital by a half and issued convertible bond.

87 Loan balance of a financial institution includes loan balance as in the loan contracts; loan balance that it delegates another financial institution to make; balance paid on behalf of others to perform its guarantee obligations.

88 For financial leases, Circular 13 stipulates that total loan balance to a lessee should not exceed 30% of the lessor’ equity.

89 Credit extension is defined as including loans, discounts, financial leases, factoring, bank guarantees and other credit extension operations.

90 Including CBs, foreign bank branches, people’s credit funds, and microfinance institutions.
of affiliated persons in the Law of Financial Institutions of 2010 is not comprehensive. Some cases regarded by Law on Enterprises and Law on Securities as affiliated persons are not covered by Law on Financial Institutions, such as contractual individuals and institutions in which one represents for the others, or a group of persons who agree on coordination to capture capital contribution, equity, or interests in a firm or dominate its decision making.

In addition, the provision in the Law on Financial Institutions that for a firm/financial institution, an individual/institution who owns 5% or more of charter capital or voting equity in that firm/financial institution or vice versa is considered an affiliated person may not be relevant under the condition that the bank charter capital is rapidly increasing.

**Box 3.1. A comparison of definitions of affiliated persons in Laws**

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>a) A parent company with its subsidiaries and vice versa; a financial institution with its subsidiaries and vice versa; subsidiaries of the same parent/financial institution with each other; managers, supervisory board members of a parent/financial institution, individuals/institutions having authority to nominate them with its subsidiaries and vice versa;</td>
<td>a) A parent company, managers of the parent company and persons having authority to nominate managers with its subsidiaries;</td>
<td>a) Father, adoptive father, mother, adoptive mother, spouse, children, adoptive children, brother and sister of the individual;</td>
</tr>
<tr>
<td>b) A firm/financial institution with its managers, supervisory board members or with firm/institution having authority to nominate them and vice versa;</td>
<td>b) A subsidiary with its parent;</td>
<td>b) An institution in which the individual is an employee, director or general director, who owns more than 10% of outstanding voting shares;</td>
</tr>
<tr>
<td>c) A firm/financial institution with individuals/institutions who own 5% or more of charter capital or voting equity in that firm/financial institution and vice versa;</td>
<td>c) A person or a group of persons who can dominate the decision making, operations of a firm via its regulatory authorities;</td>
<td>c) BOM, Supervisory Board members, director or general director, vice director or vice general director, and other managers of the firm;</td>
</tr>
<tr>
<td>d) An individual with her/his spouse, parents, children, brothers, and sisters;</td>
<td>d) Managers of the firm;</td>
<td>d) A person in the relation with another can directly or indirectly control or be controlled by the later or that person and the later are under the same control;</td>
</tr>
<tr>
<td>d) A firm/financial institution with individuals specified in d) of this section of managers, supervisory board members, capital contributors, or shareholders who own 5% or more of charter capital or voting equity in that firm/financial institution and vice versa;</td>
<td>d) The spouse, father, adoptive father, mother, adoptive mother, children, adoptive children, brother, and sister of the firm managers or members, or shareholders who have dominating holdings;</td>
<td>d) Parent and its subsidiaries;</td>
</tr>
<tr>
<td>e) An individual who is authorized on behalf of those specified in a), b), c), d), and e) of this section;</td>
<td>e) An individual who is authorized on coordination to capture capital contributions, equity, or interests in</td>
<td>e) Contractual relation in which a person is the</td>
</tr>
</tbody>
</table>
behalf of a firm/financial institution specified in a), b), c), d), and d) of this section with the authorizing institution/individual; individuals who are authorized to be representative of the capital contribution by the same institution with each other.

(Section 8, Article 4, Law on Financial Institutions of 2010)

a firm or dominate its decision making.

(Section 17 Article 4, Law on Enterprises of 2005)

representative of the other.

(Section 34 Article 6, Law on Securities of 2006)

With the minimum charter capital of VND3,000 billion as required by Decree 141, a holding of 5% is equivalent to VND150 billion. This number is supposedly too big and the fact that many individuals and institutions having less than 5% holdings of the banks’ charter capital can take control of banks is ignored.

Regarding the compliance with credit limit provisions in the Law of Financial Institutions of 2010 and Circular 13, financial institutions can deal with it by syndicated loans; in addition, in special cases when the syndicated loans fail to meet the demand for funds by a customer, the Prime Minister can approve for credit extension beyond above mentioned limits. In fact, these exceptions are usually applied for SOCBs with directed credit to the public projects and SOEs. As analyzed, these loans often lead to moral hazard, reduce the supervisory role of banks, are inefficient, and hence, create a sponsor burden on the government budget.

3.3.1.3. Solvency ratios

Circular 13 requires that financial institutions should set up asset-liability committees (ALCOs) to monitor the ability to pay for their liabilities every day. Currently, most of banks have ALCOs under the general director or the authorized vice general director's supervision. At the end of every day, financial institutions should determine and have measures to ensure the solvency ratios for the next day.

In particular, financial institutions should ensure (i) the ratio of quick assets to next-day liabilities must be at least 15%, and (ii) the ratio of total assets due in 7 days form the next day to liabilities due in 7 days from the next day must be at least 1 for VND, EUR, GBP, and USD. Circular 13 also stipulates specifically what are quick assets and assets and liabilities due in 7 days from the the next day.

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91 Other foreign currencies are converted to USD at the end of every day.
Figure 3.10. The bank solvency

![Graph showing bank solvency ratios for various financial institutions.]

**Note:**
The solvency of the banks as defined by the authors:
\[
\text{[Cash + 90% Deposit at SBV + 50% (Deposits at/Loans to FIs)]/(50% Borrowing from FIs + 25% Customer Deposits)}
\]

**Source:** Complied by FETP Research Group from the banks’ annual reports and governance reports.

In case the ratios are not met at the end of the day, FIs have to take measures to resolve, including borrowing from other FIs to enhance solvency, ensure meeting the solvency ratios for the next day, and report to SBV about measures to resolve with no provisions of specific sanctions. If FIs are still in difficulty even after implementing these measures, the SBV will deploy necessary measures to resolve, such as rediscount lending. An FI that has been supported by SBV for liquidity is not allowed to engage in the interbank market. FIs that support the others should secure their own solvency ratios. This means a FI that temporarily falls short of solvency ratios is not allowed to commit itself to lending in the interbank market.

With these provisions, one can guess which FIs are temporarily in liquidity difficulty by looking as signals such as increasing deposit rates beyond the market average, or loopholing the deposit ceiling rate regulation by some banks, especially the small ones. Many banks though having very clever ways to loophole ceiling rate regulation for any purposes are presumably illiquid. It is useful to note that loopholing ceiling rate regulation happens not only in small but also in large banks. Similarly, a bank that is a net borrower from SBV may not be in a good status in terms of liquidity (see Figure 3.11).

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92 Statistics suggest that many banks have loopholed the ceiling rate regulation such as SCB, ABBank, SeaAbank, PGBank, VietAbank, KienLong Bank, PNB, Western Bank, OCB, DongAbank, and even the large banks like Vietcombank, Sacombank, and Agribank. The SBV officially conceded the excess of deposit rate ceiling by FIs as shown in Directive 02/CT-NHNN dated 7/9/2011.
Figure 3.11. Net borrowing from SBV (billions of VND)

This is also the case in the interbank market when some banks are permanently borrowers while the others are consistently lenders. Sometimes there were zeals in the interbank market, especially in 2011. Some banks in need of liquidity had to borrow while the others found it profitable to operate in the interbank market. The interbank rate sometimes soared to the heights such as 23%/year in 3/2011 or 30%/year in 10/2011 or even 37.5%/year for some transactions, while the deposit rate was 14%/year at that time.

High interest rates means great potential risk, even in the interbank market supposed to be safe. During a long time, many FIs in need of liquidity borrowed in the interbank market but failed to pay back, so the lenders tightened loan terms and conditions, such as requiring for collaterals. Circular 02 on asset classification and risk provision that replaces Decision 493, though postponing the effective date, specifies that FIs should classify debt and establish credit risk provision just as loans to ordinary customers. In addition, since it is sensitive to claim for paying debt in the interbank market, many interbank debts are suspended. Recently, SBV has imposed a regulation to tighten the interbank borrowing activity, making this channel of liquidity support for weak banks narrower.

Source: Complied by FETP Research Group from the banks’ annual reports and governance reports.

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93In 18/6/2012, The SBV Governor issued Circular 21/2012/TT-NHNN on lending, borrowing; term purchases and sales of valuable papers among FIs. Accordingly, to engage in interbank transactions, FIs (borrowers) must have no overdue interbank debts for 10 days or more at the time the transactions are made at agreed interest rates.
Although this study does not have official information, according to what the SBV has announced, the ability to meet the demand for liquidity in 9 weak FIs\(^\text{94}\) is very low. Illiquidity in these FIs also hinders the effort to reliberalize interest rates of the SBV. In contrast, the existing interest rate control policy makes the liquidity management by FIs more difficult.

3.3.1.4. Limits on capital contributions and equity purchases

The Law on FIs of 2010 and Circular 13 stipulate that FIs use only charter capital and reserve funds to contribute capital and purchase equity. Capital contributions and equity purchases by a CB, its subsidiaries, and affiliated firms in a firm are not allowed to exceed 11% of charter capital of the capital-receiving firm; total capital contributions and equity purchases by a bank in other firms, including its subsidiaries and affiliated firms are not allowed to exceed 40% of its charter capital and reserve funds.\(^\text{95}\) According to Point a Section 4, Article 103, Law on FIs of 2010, capital contributions and equity purchases are confined to firms that operate in a few industries such as insurance, foreign exchange, foreign currency trading, gold trading, factoring, credit card issuance, consumption credit, settlement intermediary services, and credit information. Point b, however, specifies different industries that are not covered in Point a. With these provisions, the industries in which CBs are allowed to contribute capital and purchase equity are not actually limited; only limits on ratios of capital contributions and equity purchase exist. However, under the conditions of overlapping ownership, limits on equity holdings seem to make no sense because the control right via overlapping ownership is different from the ownership right.

\(^{94}\) Including the three banks, SCB, TNB, and FCB, that have been merged; Habubank merged into SHB; Tienphong Bank found a partner, DOJI Group; Western Bank merged into PVFC; and those on the way of restructuring, Navibank, TrustBank, and GPBank. In addition, there are more of other banks in financial distress.

\(^{95}\) 60% for finance companies.
Figure 3.13. Charter capital, equity, and capital contributions of commercial banks, 2012 (billions of VND, %)

Source: Complied by FETP Research Group from the banks' annual reports and governance reports.

In addition, there is a noteworthy provision in the Law on FIs of 2010, which stipulates that FIs are not allowed to contribute capital and purchase equity in firms/other FIs that are shareholders of the former (Section 5 Article 129). This provision is very important because it eliminates the simple cross ownership as defined in Sections 2.2.1. and 2.2.3 and illustrated in Appendix 5. However, it cannot remove the complicated overlapping ownership as demonstrated in Figure 2.3 and Figure 2.4.

Although the Law on FIs requires that capital contributions and equity purchases by CBs in Point b, Section 4, Article 103 should be approved in advance by the SBV in written documents, there are no specific provisions of conditions, documents, and procedures of approval. Besides, Circular 13 provides for a FI having more equity holdings than the required ratio to be approved. Two conditions for the SBV's approval are (i) complying with other regulations on safe operations, NPLs being 3% or less, and having profits for the preceding successive three years; (ii) the capital contribution or equity purchase is made to help a FI being at risk of insolvency that could affect the safety of the system. This provision can be understood as to help banks that are in liquidity difficulty and need to be supported from a financially healthy bank. However, it accidentally obscures the role of the lender of last resort of SBV. Furthermore, it is not necessary to provide liquidity for a troubled bank with capital contribution or equity purchase; recapitalizing or interbank lending for liquidity support is more justified.

In other cases, if a FI has equity holdings more than the required ratio, measures to resolve should be devised; it should not be allowed to continue to contribute capital or purchase equity, including providing charter capital to set up subunits until its good compliance. Circular 13 requires that measures to resolve should be approved by the BOM of the bank and reported to SBV, but the route of compliance and treatment of violation are not specified.
3.3.1.5. Loan to deposit ratio

Circular 13 requires that the loan to deposit ratio (LDR) should not exceed 80% for banks and 85% for non-banking financial institutions. “Loans” specified in Circular 13 including lending, financial leases, factoring, guarantees, valuable paper discount, and transfer instruments. Loans are reported on the bank’s balance sheet as Loans to Customers. Also in Circular 13, deposits based on which loans are counted include demand and time deposits from individuals, time deposits from institutions (except for those from the Treasury that should have been deposited at SBV), borrowing from domestic institutions (except for the Treasury and other domestic FIs), and borrowing from foreign FIs, and funds mobilized from institutions and individuals in the form of valuable paper issue.

Data in Figure 3.14 show that LDRs for finance companies and financial lease companies are very high, more than 130% on average, even more than 160% recently. High LDRs in finance companies and financial lease companies suggest a correlation with the financial difficulty and high NPLs in the non-banking FIs of this sort. Among CBs, SOCBs have the highest LDRs, more than 90% on average, while JSCBs have the lowest LDRs – less than 80% for the highest of them. JVCBs and foreign bank branches used to have LDRs as high as those of SOCBs but now reduce to below the system average and almost as same as those of JSCBs. If high LDRs are a reason for current problems in finance companies and financial lease companies, the next problem would be in SOCBs. In other words, SOCBs themselves are at risk of illiquidity and of potentially affecting systematic risk. It is useful to note that SOCBs (perhaps except MHB) thinks that they are too big/important to fail, and SBV itself is ready to provide liquidity to them, as not only the central bank but also the representative of the state capital owner.

Figure 3.14. Loan to deposit ratios (for Market 1)\(^\text{**}\) in FIs

![Graph showing loan to deposit ratios for different types of financial institutions.]

Source: Complied by FETP Research Group from the banks’ annual reports and governance reports.

\(^\text{**}\) Market 1 refers to the market of customer deposit and lending. Market 2 refers to the interbank market.
In practice, the provision of LDR is as controversial as that of CAR. Many critics contend that provisions of Circular 13 are unrealistic and do not reflect the state of affairs of fund raising and credit extension by FIs. In particular, after Circular 13 was issued, many FIs contend this provision is unreasonable because the narrowly-defined deposits based on which credit extensions are counted lock up many other funds of FIs from productive lending and few banks can meet this requirement in the short run. VNBA suggests that deposits used for lending that do not include demand deposits from economic organizations (EOs), the Treasury, and Vietnam Social Insurance are not justified, because demand deposits of this sort account for $15\% - 20\%$ of total deposits in FIs. Hence, also according to VNBA, the part of funds to secure the solvency of $20\% + 15\% = 35\%$ of total mobilized funds is too high and unreasonable. Furthermore, it is concerned that when LDR is limited, FIs are likely to increase lending rates to cover their increased cost of capital due to increases in the less or even no profitable portion of funds. Facing this possibility, many FIs suggest an increase in the required LDR to $90\%$ or even $95\%$.

In addition, in fact many FIs use not only funds mobilized from individuals/institutions but also equity, funds mobilized in the interbank market, and even OMO funds to make loans. To reduce waste of resources and release some more funds for credit extension, some suggest that, in stead of "loan to deposit ratio", the SBV should use "loan from deposit" requirement. It means that, in stead of a comparison of loan and deposit, other funds from interbank market, OMO, or equity used for credit extension should not be subject to limits.

The SBV responded to this suggestion by issuing Amended Circular 19 in which deposits based on which loans are counted additionally include time deposits and borrowing from the Treasury, $25\%$ of demand deposits from EOs (not FIs), 3-month-or-more borrowing from FIs (not that for resolving the temporary insolvency). Despite the amendment toward relaxing the definition of deposits, many banks fail to meet the required LDR of $80\%$. Facing this reality, in stead of more relaxing LDR, the SBV issued a circular to rule out the LDR requirement. In doing so, the expectation is that the FIs' funds available for the economy are more abundant and serve as grounds for decreases in lending rates, and hence, tapping the credit flows that have been recently clogged. However, this short-term benefit should not be traded off with the long-term risk that banks may fall into financial difficulty like finance companies and financial lease companies currently.

3.3.2. Overlapping ownership neutralizes safe banking regulations

Section 3.3.1 shows the state of affairs of compliance with safe banking regulations. As analyzed, many banking supervisory regulations are violated or neutralized. SBV should have strict sanctions for violations. For a large part, however, supervisory regulations are not effective for joint ownership groups. In other words, various forms of overlapping ownership are supposedly a reason for ineffectiveness of safe banking regulators. To evaluate the supervision over overlapping ownership among FIs and economic groups in Vietnam, this section analyzes how banks deploy overlapping ownership to neutralize safe banking regulations. Then, reasons for failure of the supervisory system over overlapping ownership are discussed from the legal and institutional perspective.

During 2006-2011, the banking oversight and legal framework were constantly modernized. Current regulations on safe commercial banking cover all areas of capital, credit limit, limit on equity
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Investment and contribution, solvency ratio, debt classification, and risk provision. Banks, essentially investors and EOs that own banks, however, can easily neutralize all regulations, even those based on international standards. It is noteworthy that the neutralization of regulations— not against the letter of the law, but against the spirit of the law in many cases— occurs based on various forms of overlapping ownership in which SOEs own JSCBs, banks own firms, banks own banks, big investors own banks, non-financial companies, financial investment JSCs, and securities companies. Presumably, the supervision over overlapping ownership in the banking system has failed and the evidence is the following facts:

First, the regulation on legal capital is neutralized. Decree 141 requires the legal capital of VND3,000 billion for JSCBs by late 2010. Some banks have met this requirement in time but many others, especially those have transformed into urban from rural JSCBs, fail to meet the required legal capital. The simplest way for them to raise sufficient capital is to lend to affiliated firms, which in turn purchase equity in banks that share ownership with the lenders. Thus, debtors become the owners of banks. A typical example is the fact that SCB lends to Van Thinh Phat and affiliated firms, which in turn use the borrowed money to make capital contributions to TNB and FCB. In terms of ownership, SCB, FCB, TNB, and Van Thinh Phat belong to the same owner, so the requirements on evaluation and oversight of borrowing transactions and capital contributions are not complied.

Second, the CAR regulation is neutralized. CARs in most of bank, except Agribank during 2009-2011, are higher than the minimum of 9% as required by SBV. In particular, CARs in some bank are unrealistically high, such as 54.92% in Gia Dinh Bank in 2010, 37.3% in MKB in 2010, and 50.2% in pre-merger SCB in 2009. In fact, they are all weak banks. Relating to the compliance with CAR regulation, the current overlapping ownership helps banks evaluate their risky assets inaccurately, and hence, increase their CARs unrealistically. Current regulations put loans to securities investments and real estate businesses into the risk categories of 250%. In fact, many banks lend a significant portion of their capital to securities and real estate investments via their subsidiaries and affiliated firms. However, overlapping ownership makes it hard to evaluate the ultimate purposes of loans, therefore these loans may be grouped into less risk categories. Underestimating risk means that CARs do not actually reflect the capital adequacy of the banks—a strictly regulated international standard. The evaluation of CARs is unrealistic partly because it is hard to separate investment and commercial banking due to overlapping ownership.

Third, the regulation on separating investment and commercial banking is loopholed. Experiences from the financial crisis of 1929 – 1933 and especially the subprime debt crisis of 2007-2008 in the U.S. point out the danger of the intertwist of investment and commercial banking operations. By law in Vietnam, CBs are not allowed to do securities business, but they can set up securities companies to do it indirectly. However, banks are not allowed to extend credit to their subsidiaries that operate in the securities industry and to make unsecured loans to securities investments. But banks are not prohibited to lend to securities investments by other firms; rather, regulations only require that loan balance to and discount on securities should not exceed 20% of the charter capital of the bank, not to mention exceptions. An example of loopoling these regulations is ACB in 2010 that thanks to having 19.52% of shares in DaiABank, invested VND1,000 billion bond in the later, which in turn

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97 See Article 10, Circular 13/2010/TT-NHNN on safe banking ratios.
poured VND700 billion to ACB Securities (or ACBS, 100% owned by ACB) in the form of ACBS bond held by DaiABank.

Fourth, the credit limit regulation is neutralized. By law, loan balance to a customer and a group of affiliated customers must not exceed 15% and 25% of the bank equity, respectively. The figure of 25% is presumably a large portion of the bank equity and cannot ensure the risk pooling in lending. With this regulation, in stead of setting up a firm, one can set up many firms to borrow money from banks, and hence, legally increase the limit from 15% to 25%. Furthermore, it is not easy at all to determine the affiliated persons due to complicated overlapping ownership. That is why some groups of de facto affiliated customers are not covered in the legal definition and can borrow more than 25% of the bank equity. In addition, since the definition of credit previously did not include bond trading, many banks, in stead of traditional lending, turn to buying bond issued by firms that belong to the same owner, and hence, drive the credit extension upward. For example, in 2011, LienVietPostBank not only made a down payment of VND1,961 billion to Him Lam JSC but also additionally paid VND250 billion for its bond, leading to total loan of 33.54% of the bank equity to a single customer, far beyond the 15% limit.

Fifth, limits on capital contributions and equity purchases are neutralized. Banks are not allowed to use deposit to contribute capital and purchase equity; only use of charter capital and funds are allowed for these purposes; moreover, the equity holding is limited to 11% of equity of the capital-receiving firm. In addition, the total equity holdings by a bank in all of its subunits must not exceed 25% of its equity and funds. However, with bond investments and investments trusted directly or indirectly through affiliated firms, banks can still take control of firms, projects, and even other banks. For example, Maritime Bank though having only 10.2% shareholding in Mekong Bank (MDB) can easily dominate the later via Tin Phat Fund which has up to 18.5% shareholding in MDB.

Sixth, the regulation on reporting loan quality and risk provision is neutralized. Determining accurately NPLs, and more importantly, transparent disclosure of NPLs, are necessary to enhance accountability of the bank BOM to regulatory authorities and investors, especially minor shareholders. Many banks set up asset management companies (AMCs), however, they play a low-key role, basically helping banks “clean up” their balance sheets. Via AMCs, banks can loophole regulations by delegating AMCs to collect debts. Through this power of attorney, banks can hide NPLs from their balance sheets, and replace them with something that seems not to be related: accounts receivable. Also, overlapping ownership helps banks easily relax regulations on loan appraisal and supervision; hence, loan conversion is easier and loan quality evaluation is less realistic. Banks can convert NPLs into other assets by moving them to subsidiaries and affiliated firms. Since NPLs are not accurately counted, risk provision is not sufficient and the bank owners can avoid from decreases in profit and dividends, but depositors are at risk.

In short, the ownership structure of the banking system now in fact helps a few groups of investors or firm owners own one or more banks in particular and FIs in general. These owners transform FIs into an instrument to mobilizes funds to speculate in assets as above discussed or create M&A, manipulate the markets, violate safe operating regulations. Typical examples of non-compliance with the banking oversight framework by means of overlapping ownership are discussed in more details in Sections 0 and 0.
3.3.3. Non-compliance with the oversight framework in SOCBs

As shown in Section 0, the fact that the government is both the representative of the SOCB owner – the one being supervised – and the supervisor leads to the ineffectiveness of supervisory framework. The CAR provision is the first example about the ineffectiveness of supervisory framework over SOCBs. Under current regulations, CAR of a CB must be at least 9%. This ratio, however, was only 8% in CTG and even 6.1% in Agribank as of 12/2010. In 2011, CAR became 10.6% in CTG but was still 6.8% in Agribank. When a CB does not reach the required CAR, the SBV would ask it to increase equity, reduce the growth of total assets, change the asset structure toward an increase in the portion of safe assets or all of above adjustments. Yet the SBV did not do anything with above violations. It shows the weak law enforcement and sanctions. The moral hazard would arise in all other banks with other financial ratios.

Figure 3.15. Overlapping ownership between SOCBs and SOEs

Since the government is the SOE owner and the dominant shareholder in SOCBs, credit limit provision for a single customer would be ineffective. When a SOCB wants to lend to a customer more than 15% of its equity, it would ask for the SBV and the government’s approval for its non-compliance. Figure 3.15 illustrates the credit extension exceeding 15% of equity by SOCBs to Huoi Quang (Son La) Hydropower Project in Vietnam Electricity (EVN). EVN and three SOCBs – Vietcombank, BIDV, and Agribank – are owned by the government. Thus, the government assigned these banks to lend to EVN project. Since the project size was so large, the government allowed banks to make loans exceeding 15% of their equity. To be qualified to lend VND10,500 billion to a customer, the bank equity must reach VND70,000 billion, while no CBs in Vietnam have equity higher than VND30,000.

Credit limit to a customer is an international monitoring norm to protect banks from bankruptcy risk due to huge credit extension to an inefficient project or a failed borrower. This is an important monitoring framework which banks should always strictly comply with. Breaking the monitoring framework can lead to NPLs borne to banks and the bankruptcy risk as NPLs are too large. Bad debt of Vinashin is an example of the impact of credit concentration on some banks that have financed this group. With the government’s approval, alone BIDV has lent to Vinashin VND6,600 billion, exceeding 15% of the bank equity. Currently, total loan balance to Vinashin in BIDV is VND5,000 billion (after
transferring VND1,600 to Vinalines). With this total loan balance, BIDV must have made risk provision of VND4,500 billion (expectedly VND1,500 billion in 2011 and VND3,000 billion in the following year), or 90% of total loan value. Furthermore, SOCBs are allowed to “suspend” these loans rather than officially report them as NPLs in their financial statements and make risk provision based on their financial capability. This policy creates an incentive of non-compliance and leads to the banks’ discretion.

According to official data, the loan balance to large SOEs now is VND415.347 billion, or 16.9% of total loan balance, including VND218,000 billion to 12 state-owned economic groups. Alone the insolvency of Vinashin pushes 38 creditors-bankers into difficulty, including Habubank (HBB) that have been merged into Saigon Hanoi Bank (SHB). Thus, to ensure safe operations for SOCBs and the banking system, safe banking regulations should be strictly complied with no any exceptions.

As above mentioned, directed lending leads to a moral hazard in SOCBs. If they get into liquidity difficulties, SBV will bail them out with recapitalization. Hence, in couple with credit and equity limits, the regulation on liquidity and NPLs is also neutralized due to the cross-ownership relations between SOCBs and SOEs. This suggests that SBV, while setting forth the regulations, has opened some exceptions for non-compliance by SOCBs and their transactions account for a significant volume. In other words, being owned by the government helps SOCBs avoid from compliance with the oversight framework. This can also explain why overlapping ownership is not too complicated in SOCBs as depicted in Section 0. Clearly, with exceptions and privileges, SOCBs themselves do not need to resort the overlapping ownership to loophole the supervisory framework. In the meantime, JSCBs have few exceptions, so overlapping ownership is an effective way to neutralize oversight regulations.

3.3.4. Non-compliance with oversight framework in JSCBs

As shown in Section 0, since JSCBs are hard to have access to exceptions to compliance with the oversight framework, overlapping ownership is an effective way to overcome credit limits and safe banking regulations. This section discusses some typical cases to see how overlapping ownership helps JSCBs neutralize safe banking regulations.

3.3.4.1. The case of ACB

As shown in Figure 3.6, ACB has quite complicated overlapping ownership with many other banks. Information from notes on financial statements and income statements of ACB, DaiABank, KienLong Bank, and VietBank reveals that ACB has shareholdings in three JSCBs: 10.82% in DaiABank, 6.13% in KienLong Bank, and 10% in VietBank. Given its shareholdings complied with current regulations, ACB seems to be a large, rather than a dominant, shareholder in these banks. However, looking closely at the personnel of the BOMs or the BOS of the three banks, one can see the possibility of ACB’s control in these banks. As illustrated in Figure 3.17, at KienLong Bank, although its shareholding is not high, ACB has two member chairs in KienLong BOM. Currently they are the Chief Accountant and Deputy General Director in ACB. Similarly, in VietBank, in addition to the declared shareholding by ACB (10%), the wife of a main founding shareholder in ACB is a BOM member and has 4.99% shareholding (just sufficient to avoid from being tied as a large shareholder.
and disclosing information) in VietBank. Besides, the Deputy Chairman of BOM, concurrently General Director of VietBank had been working for many years and held important positions in ACB.

In the third bank, DaiABank, ACB holds only 10.82% shares. However, Mr. Do Minh Toan, Deputy General Director of ACB, and Mr. Nguyen Van Hoa, Chief Accountant of ACB, have 4.32% and 4.38% shareholdings in DaiABank, respectively. In effect, ACB holds 19.52% shares in DaiABank. Mr. Toan had been the BOM member and Mr. Hoa the member of supervisory board of DaiABank until 2010. Hence, ACB actually has impacts on DaiABank by having dominant shareholding (19.52%) and two members of ACB management involved in BOM and supervisory board of DaiABank.

Using not-against-the-law overlapping ownership, ACB has large influences on other banks owned by it. Figure 3.16. shows that during 2010, ACB invested VND1000 billion in DaiABank bond, and then the later bought VND700 billion bonds from ACB Securities (ACBS). Hence, in effect, ACB financed VND700 billion to ACBS via DaiABank to loophole the regulation that banks are not allowed to lend to their subsidiaries operating in securities business (Section 7, Article 8, Circular 13). In essence, these bond investments are a lending transaction, because the bond portfolios are not listed and traded in the market, and the bondholder – DaiABank – notes on its financial statements that it will hold them to maturity. In lack of specific regulations on corporate bond investments by CBs, ACB was against the spirit of the regulation that does not allow CBs to extend credit to their subsidiaries that operate in securities business.

Figure 3.16. ACB invests in ACBS via DaiABank

Source: Complied from DaiABank financial statements of 2010.

If ACB had not had overlapping ownership with DaiABank, it could not have lent to ACBS or it would have to loophole the law in another way. Thanks to overlapping ownership, ACB neutralized the regulation that prohibits CBs from lending to their subsidiaries operating in securities business. In addition, as a distinct point of the ACB Board of Management from those of other banks, its main shareholders such as Mr. Tran Mong Hung and Mr. Nguyen Duc Kien do not sit in the BOM, although both of them are the bank founders and have large shareholdings in ACB. Instead, they are ACB founding members only.\(^8\) Hence, if it wants, ACB can loan to them, because current regulations

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\(^8\)Board of Founders is a notion that is not covered in the Law of FIs, but created by banks themselves to avoid from being tied by regulations on BOM or Board of Executives. Thus, in relation to the case of Nguyen Duc Kien, according to the SBV Governor, Mr. Kien, in his position, is not affiliated with ACB. According to Nguyen Thi Kim Ngan, Deputy Chairperson of National Assembly, however, the SBV is blamed for letting the ACB Board of
only prohibit banks from lending to BOM members, not the founding members.\textsuperscript{99} Certainly this is a loophole that many banks are taking advantage of. The case of Nguyen Duc Kien is a clear proof of deficiencies in current regulations and lack of activeness of the SBV in finding out and dealing with loopholing that is very pervasive in banks currently.


\textsuperscript{99} Law on FIs of 2010, Article 126, Section 1.
Figure 3.17. Overlapping ownership between ACB and other 3 JSCBs: DaiABank, KienLong Bank, and VietBank (5/2012)

Source: Complied by FETP Research Group from the banks' annual reports and governance reports.
3.3.4.2. The case of An Binh JSCB (ABB)

ABB is a case for negative impacts of overlapping ownership. It is useful to note that this is the overlapping ownership between a JSCB and a SOE. ABB has two main institutional shareholders – EVN and Geleximco. Pursuant to the Law on FIs, CBs are not allowed to extend credit to legal-person shareholders whose representatives have made capital contributions to the bank. Both shareholders in An Binh have their representatives in the bank board of management (BOM). Geleximco’s representative (Mr. Vu Van Tien) is An Binh BOM Chairman and EVN’s representatives (Mr. Nguyen Van Hoi and Mr. Dao Duy Hung) are An Binh BOM members. As in the case of ACB, An Binh has financed both its legal-person shareholders through bond investments. As illustrated in Figure 3.18., An Binh financed VND1,000 billion to EVN and VND500 billion to Geleximco in 2010.100

Figure 3.18. Overlapping ownership between Geleximco, EVN, and ABB

![Diagram showing overlapping ownership between Geleximco, EVN, and ABB.]

Source: Complied by FETP Research Group from the ABB and affiliated firms’ annual reports and governance reports.

The case of ABB also explains why SOEs have incentive to contribute capital to JSCBs. After contributing capital to An Binh, EVN opened deposit account at this bank. EVN’s deposit turnover at An Binh was VND24,000 billion and VND9,500 billion in 2010 and 2011, respectively. Its deposit balance was VND1,461 billion and VND1,758 billion as of 31/12/2010 and 31/12/2011, respectively.101

Given the severe contest for deposits among banks by continuously increasing interest rates in recent years, large deposits by EVN are presumably a great support of capital and liquidity to ABB. The question is whether the benefits of deposits accrue to EVN or go to some powerful individuals in this group.

Through overlapping ownership, CBs loophole the oversight framework in many forms. This lead to NPLs and bad assets borne to minor shareholders and depositors if the government does not bail out. Overlapping ownership makes it hard to supervise CBs by the SBV; however, the first and most obvious sign is always the shortage of liquidity in weak banks for a long time. Section 0 discusses the case of the three-bank merger in 12/2011 to see how overlapping ownership is related to illiquidity in some banks.

100 ABB financial statements of 2010.
101 ABB financial statements of 2011 and 2012.
3.3.4.3. The case of the three-bank merger

On 26/12/2011, The SBV Governor issued Decision 2716/QĐ-NHNN on the merger of three JSCBs including Saigon Commercial Bank (SCB), TinNghiaBank (TNB), and Ficombank (FCB).

By mid-2011, the three banks had been jointly controlled by a group of investors and affiliated companies, although nobody had nominally shown up as a major shareholder owning above 5% of total share value. Figure 3.19. presents part of the overlapping ownership picture of three banks and the group of affiliated firms. As shown in the figure, through assigning their representatives to the three banks’ BOMs, the ultimate owners (Ms. Truong My Lan and Van Thinh Phat Company) take full control of the banks.

Being actually held by an owner, SCB, TNB, and FCB all financed various investments in firms controlled by the same owner. A visible example about a bank lending to property projects owned by the banker itself is the two projects among the largest ones in HCMC – Times Square and Saigon Peninsula. The sponsor of Times Square is Times Square Investment JSC. And the sponsor of Saigon Peninsula is Dai Truong Son Investment JSC. Here, once again, the concept of “Investment JSC” appears. In an announcement ceremony of unique projects in HCMC, HCMC Real Estates Association (HoREA) stated that SCB, TNB, and FCB were the largest lenders to the two property projects.102

Figure 3.19. The case of the three-bank merger

Source: Complied by FETP Research Group from the banks and affiliated firms’ annual reports and governance reports.
Another example about banks financing firms owned by the same main shareholder is the fact that TNB bought corporate bond issued by Van Thinh Phat. On 11/9/2010, Van Thinh Phat JSC issued bond for VND6,000 billion. According to the notes on TNB financial statements of 2010, the bank held all VND6,000 billion Van Thinh Phat bond, while its equity was VND3,902 billion. Like the cases of ACB and ABB, the bond is classified as investment bond, which is held until maturity, and not accounted as a loan balance in TNB.\(^{103}\) Banking experiences suggest that easy credit extension to customers, especially the bank shareholders, is very likely to become NPLs in a while. When loans are not paid back in time, CBs are required to make full risk provision. Increased risk provision lowers the bank profitability, while the NPL ratio increases. Complying with the SBV regulation, banks with high NPLs would incur losses. Then, its equity and CAR would reduce. When CAR is lower than 9% as legally required,\(^{104}\) CBs would have to explain to shareholders for raising equity to keep up with legal CAR. This practice helps strengthen the bank’s financial situation but it can lead to changes in part or entire of the bank’s BOM and the board of executives.

Thus, to avoid from NPLs, CBs could refinance loans to borrowers by extending new credit to help them pay back all the due debt principal and interest. This increases total loan balance but helps hide the actual NPLs. In addition, banks would not need to make risk provision and their business performance would be counted as profitable. Since this practice is tightly supervised by the SBV’s verification of loan records and regulation on annual credit growth rate, CBs evade in many ways. CBs could delegate their asset management companies (AMC) to invest jointly with customers. Hence, these investments would be written as “other assets” rather than “loans to customers” on the bank’s financial statements. This practice helps banks evade compliance of regulations on annual credit growth rate and risk provision. Due to these practices, some banks that announced low NPLs and profitable performance do not want to or cannot pay cash dividends, or even face liquidity difficulties in a long time.\(^ {105}\) As a result, the government has to bail them out using money from the taxpayers, as the SBV and BIDV refinance them.\(^ {106}\)

3.3.4.4. The takeover of Sacombank

Overlapping ownership makes it hard for the SBV to supervise banks. The ownership structure amongst banks is increasingly complicated and hard to figure out. Recent changes in the shareholdings in Sacombank (STB) are an example. One would not know about the existence of Saigon Exim Investment JSC (Saigon Exim) – an affiliated firm of Eximbank – without the announcement of the main shareholder who has more than 5% shareholding in STB. Eximbank is one of the three founding shareholders in Saigon Exim. The other founders are Eximland Corporation and Saigon Development and Investment JSC (SDI). Also, Mr. Nguyen Thanh Nhung, Eximbank Deputy General Director is a BOM member in Saigon Exim.\(^ {107}\) Affiliated firms are an effective tool for main shareholders in banks to loophole the law. For example, Saigon Exim is used by Eximbank to buy

\(^{103}\) According to financial statements of quarter III/2011, TNB still held VND2,200 billion Van Thinh Phat bond, or 54.8% of its equity at that time.

\(^{104}\) Circular 13, op. cit.

\(^{105}\) According to financial statements of quarter III by the three banks, during the first 9 months of 2011, total assets of the three banks increased from VND114,369 billion to VND153,625 billion – a growth rate of 34% - while other assets increased from VND22,056 billion to VND53,486 billion – a rate of 142.5%.

\(^{106}\) TTXVN (2011).

\(^{107}\) DVT/HSX (2012).
shares in STB. Another bank that also bought shares in STB without disclosing information like Eximbank is Southern Bank (PNB). Four individuals that affiliated with PNB have been elected as BOM members in STB for 2011-2015.\textsuperscript{108}

In addition to the above mentioned cases, the use of overlapping ownership to neutralize safe banking regulations is pervasive in other CBs. As illustrated in figures in this chapter, the lender-owner relations also exist between other banks and their shareholders/affiliated firms, such as those between LienViet Bank and its shareholder, Him Lam JSC; PG Bank and customers from Petrolimex – a shareholder in PG Bank, and so on.

As discussed, overlapping ownership leads to many consequences for banks and the financial system as a whole, ranging from temporary liquidity difficulties to longer term credit risk. High NPLs have been analyzed with various reasons from different points of view but it would be insufficient not to mention the role of overlapping ownership. Section 0 briefly shows the NPLs in the banking system in relation to overlapping ownership.

3.4. Why is the supervision over overlapping ownership failed from the institutional point of view?

Bankers are characterized by their profit-seeking incentives wherever they are - in the U.S., Japan, Germany, or Vietnam. Why does the cross or overlapping ownership that has been well worked in Japan and Germany lead to so many negative consequences in Vietnam? The failure in monitoring overlapping ownership is partly due to some technical reasons, such as lack of regulations or the irrelevant, incoherent existing regulations. The Vietnamese financial system regulators' efforts to approach international practices should not be denied. However, these efforts should take into account the actual effectiveness on the ground of good knowledge about international standards and regulations so as to use the right measures suitable for Vietnam. In addition, it takes time and requires an appropriate route to adopt new practices; immature and subjective actions would lead to so unrealistic obtrusive administrative policies that the subjects governed by them find it hard to comply or have to do so in a crafty way. Despite of the importance of technical problems, their correction will not radically resolve the violations of safe banking regulations if fundamental institutional problems are not properly changed. Looking at how the current ownership structure of the banking system is formed (as shown in Chapter 1) and how serious the agency problems in the banking sector are (Section 2.1), one can see four institutional reasons.

First, regarding the agency problem, most importantly, institutions to mitigate the interest conflicts among stakeholders are necessary. In Vietnam, when government agencies or politicians who make policies to regulate the financial system and markets are also the bank owners, the interest conflicts are very severe.

Second, regarding the agency problem, it is critical to establish institutions to control agents and reduce the moral hazard. With the interlacing affiliation amongst banks, 29 of 34 private JSCBs are directly or indirectly kin of SOCBs, the government agencies, or SOEs, the moral hazard is not only

\textsuperscript{108} Q. Nguyễn in TTVN (2012).
far from reducing but also significantly increasing. Six of nine weak banks in need of restructuring are
directly or indirectly owned by economic groups, SOEs, and SOCBs. Debtors who are SOEs or
economic groups are subject to moral hazard, looking forward to enjoying the debt
rescheduling/deferment/cancellation by the government. Banks also have moral hazard, and hence,
lack responsibility for appraisal and supervision of loans to SOEs and economic groups. Moreover, it
is supposed that the government would not let any bank fail, leading to increased moral hazard. This
can be seen in the way the SBV has recently dealt with weak banks. During 2008-2010, the American
and British governments, which do not advocate the state ownership in firms,
explicitly refinanced or
even acquired banks hit by the crisis to secure the depositors’ interests, but bank owners still have to
be partly punished for their behaviors. Although the legitimacy of the bail out policies are
controversial in the U.S. and U.K., it would not be deniable that the transparency creates grounds on
which stakeholders hold accountability for the money from taxpayers and reduce the bankers’ moral
hazard. In Vietnam, the SBV assigned BIDV to support the merger of three weak banks\textsuperscript{109} – SCB, TNB,
and FCB – with refinancing thousands of billions of VND to them.\textsuperscript{110} Although there is nothing wrong
with the intervention to stabilize weak banks and secure the depositors’ interests, the non-
transparency of the role and accountability of stakeholders, and the way the owners of weak banks
still hold up their positions thanks to the state financing lead to ever increasing moral hazard.

Third, it is crucial to set up institutions to mitigate the negative consequences of asymmetric
information through increasing transparency and the control power of the market. Many violations of
safe banking regulations are not found out or timely uncovered due to inadequacies in information
disclosure. In one hand, the update and declaration of essential information are not required; on the
other hand, some can avoid from the requirement of information disclosure and the others do not
comply with it outright. Pyramidal, overlapping, and even shadow ownerships are used to capture
power and secure personal profit at the expense of the financial system, minor shareholders, and the
people; all have been occuring in this non-transparent environment. At the same time, banks would
have incentives to compete better in a more transparent environment since they are supervised by not
only regulatory authorities but also all stakeholders.

Fourth, aiming at encouraging self-criticism and reducing moral hazard, it is important to have
institutions that enhance accountability, and articulate and strictly enforce sanctions of violations.
From 2010 up to now, there are many contests for deposits among banks by increasing interest rates
and many cases in which banks break the law on safe operations, but few bank leaders or owners take
responsibility and receive proper punishments. This can be explained by weaknesses in oversight
mechanisms and the quantitative and qualitative constraints in human resource capacity of the
regulatory authorities. Even if violations are discovered, weak sanctions and non-stringent
punishment will not discourage banks from non-compliance right from the start. When the rules of
the game and the referee are not strict, players’ cheating is inevitable. This, in turn, depends on the
motivation of policymakers. In Vietnam, only if the interest conflict that occurs when policymakers
are also those who are governed by the policy is eliminated, other changes would be hopefully
possible.

\textsuperscript{109} http://baodientu.chinhphu.vn/Home/BIDV-hop-tac-toan-dien-voi-3-ngan-hang-chuan-bi-hop-
nhat/201112/104131.vgp
\textsuperscript{110} http://www.sggp.org.vn/kinhte/2011/12/275318/
3.5. Deficiencies in the legal framework for supervising overlapping ownership

Overlapping ownership between FIs and economic groups that abounds in the banking system and its consequences have been widely discussed since 2011 and emphasized in a study by the Fulbright Economics Teaching Program, Harvard University, in early 2012.\textsuperscript{111} It implies that by that time, the oversight mechanism of the banking system in particular and the financial system in general has not been designed and prepared for \textit{purposely} supervising and dealing with overlapping ownership. Furthermore, even when it has been officially recognized,\textsuperscript{112} the SBV does not have policy actions necessary to address it.

Although it has not been purposely designed, the banking oversight system has created a certain framework for supervising overlapping ownership. Supervising CBs in Vietnam now is centrally carried out by the Banking Supervision Inspection Agency (BSIA). The supervisory framework is adopted pursuant to the Law on FIs. In addition, since JSCBs are public companies, the Law on Securities is another supervisory framework for these banks.

In the existing supervisory framework, provisions that are directly related to overlapping ownership include:

- \textit{Shareholding ratio by FIs, limits on capital contribution, Law on FIs, Circular 13};

- \textit{Affiliated persons (including groups of affiliated customers, firms that are subunits of FIs, joint venture companies, and affiliated firms) as stipulated in the Law on FIs and Circular 13 (Circular 13/2010/TT-NHNN dated 20/5/2010 by the SBV on safe banking ratios)};

- \textit{The “Draft circular on limits and ratios for ensurance of safe operations in FIs and foreign bank branches” of 2014 to replace Circular 13}. 

In addition, the oversight of implementation of regulations on overlapping ownership is conducted via provision of information disclosure:

- \textit{Decision 16/2007/QĐ-NHNN dated 18/04/2007 by the SBV on reporting financial statements by FIs};

- \textit{Circular 52/2012/TT-BTC dated 5/4/2012 on “A guideline of information disclosure in the securities market”};

Sanctions in relation to overlapping ownership include:


\textsuperscript{111} The report is entitled “Structural reform for the purpose of growth, equity, and sovereign”, prepared for 3th annual Vietnam Executive Leader Program (VELP) in the Kennedy School of Government, 12-17/2/2012.

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- Decree 202/2004/ND-CP dated 10/12/2004 by the government on administrative fines in the monetary sector and banking activities;

Hence, to a certain extent, supervision over overlapping ownership in Vietnam has been specified in legal documents, including the law and documents under the law. Though, there is a gap between the actual oversight and the demand for oversight for the following reasons:

First, CBs’ activities in the financial markets are now very complicated. CBs carry out not only commercial but also investment banking activities (securities market) and (life and non-life) insurance company operations. Despite intensifying its operations recently, BSIA tends to monitor commercial banking activities while the supervision of other activities are limited in terms of capacity or human resource and legal framework. For example, monitoring the investment banking activities or securities trading requires the role of Securities Inspection Agency; supervising the life and non-life insurance business operations requires the role of Insurance Supervisory Authority. This statement suggests that, due to the complexity of the CBs’ activities, the efficient supervision requires the united oversight framework and close coordination amongst supervisory agencies. As in the case of Vietinbank, for example, it owns securities company, fund management company, and life and non-life insurance companies. Alone BSIA is certainly not sufficient to supervise properly this bank’s operations.

Second, since the legal capital requirement of VND3,000 billion for a CB is very large and CBs are characterized by trading on loanable funds, it is necessary to disclose information for the market oversight. The draft circular to replace Circular 13 specifies provisions on ownership amongst FIs, reduces the maximum holding requirement, and articulates the affiliated persons and limits on capital contribution/equity purchase; however, since the current disclosure requirement applied for shareholdings of 5% and above is quite high, there are room for institutional and individual shareholders in FIs to avoid from disclosure. This statement implies that the shareholding threshold subject to disclosure requirement should be lower to enhance the market oversight.

In practice, after the government and SBV have determinedly dealt with overlapping ownership in FIs, shareholders and groups of shareholders whose holdings are against regulations have quietly disinvested. However, information on shareholders who have received the transferred holdings is still limited. For example, three Vietnamese shareholders have invested almost USD55.5 million to buy nearly 15% VP Bank shares from OCBC. Their identities are known via a report by Singapore Bussiness Review while official announcement from VP Bank only says generally “domestic individual investors.”

Third, current sanctions should be redesigned because they are not sufficiently effective or tend to criminalize civil relations. In particular, the SBV’s sanctions applied for CBs’ non-compliance include: (i) Pecuniary penalty; (ii) Restricting the expansion of FIs (stop issuing permissions for setting up branches and transaction offices); and (iii) Transferring to inspection agencies.

An example of ineffective pecuniary penalty by SSC for violation of disclosure requirement is the case of Mr. Tran Phat Minh, who was the 12th richest on Vietnamese securities market; he was fined of VND70 million for selling 876,450 STB shares in Sacombank – or 4.94% of total outstanding STB shares – and not reporting to SSC and Ho Chi Minh Securities Exchange (HoSE).

Fourth, it is necessary to require for documentation of the sources of funds for large shareholders in FIs, such as in the cases of VP Bank and Tran Phat Minh. With a transparent and comprehensive legal framework, FIs know what they are and are not allowed to do. The supervision of and dealing with violations then can be done using the market discipline and regulatory discipline via disclosure without resorting the criminalized measures. This is appropriate with the general supervisory trend and facilitates the FIs’ operations.

3.6. NPLs and resolution of weak banks in the context of overlapping ownership

3.6.1. NPLs in relation to overlapping ownership

Accompanied with overlapping ownership in the banking system is NPLs. However, a closer look reveals that it is not merely an accompanying relation; it is more likely to be a causation. That is, to a certain extent, overlapping ownership is one among reasons for high NPLs in the banking system. As analyzed in Section 0, overlapping ownership is a way by which banks loophole credit limit regulation, qualifications, and constraints under which loans are allowed. Banks have incentives to relax constraints for credit extension to customers with which banks have ownership relations. In contrast, firms that have holdings in banks may influence the banks’ policies, conditions, and processes in which loans are provided for themselves, so that supervisory requirements and compliance with credit management are ignored. Bank employees who appraise loans merely play the role of agents, doing the paperworks, or even are forced to legalize the loans to banks’ affiliated firms. Hence, loans are easily provided and not based on appraisal of customers’ financial feasibility and paying capacity. In other words, the credit relation here is as same as the directed credit relation of banks and SOEs under the government’s direction.

Not only credit appraisal but also security asset evaluation are not reliable in the presence of overlapping ownership. Overestimating security assets to raise the credit lines has been identified. This leads to some risks: (i) loans are provided in excess of the banks’ capacity to absorb risks, (ii) risk provisions are not sufficient because they have been adjusted based on overvalued security assets, (iii) when the asset market is going down, leading to decreases in values of the assets backing the loans, and increases in the unsecured portion of loans, and hence, the risk of delinquencies. This actually happens for many property-backed loans. Properties were preferably used as collaterals by many banks in credit relations. In the past years, properties were overvalued partly due to the bubble and partly on purpose. When the property market has been going down and frozen, NPLs to real estates increased, leading to an increase in the NPL ratio of the system.

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115 Mr. Nguyen Ba Thanh, Head of Central Department of Interior, the former Party Secretary of Da Nang Province, contended that NPLs are partly due to bad conduct of bank officials who collude with customers to overvalue security assets. Accessed at http://tuoitre.vn/Kinh-te/570533/no-xau-do-dao-duc-can-bo-ngan-hang.html, on 28/10/2013.
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Official reports from banks suggest an average NPL of 4.08% of total loan balance for the system as a whole in late 2012 while SBV Inspectors reported a ratio of 7.8%. The SBV Governor also contended that NPL ratio was about 10% but the estimate from Fitch was 15%. However, even the figure from Fitch does not satisfy those who are pessimistic about NPLs in the Vietnamese banking system. A recent study by FETP Research Group shows a NPL ratio of 18% of total loan balance.\textsuperscript{116}

**Figure 3.20. NPLs in the Vietnamese banking system**

![Diagram showing NPLs in the Vietnamese banking system]

Source: Vũ Thành Tự Anh, Trần Thị Quế Giang, và Đỗ Thiên Anh Tuấn (2013).

Although there is no research on the relation of overlapping ownership and high NPLs, some economists contend that this is absolutely possible. Mr. Le Xuan Nghia – former Head of SBV Strategy Administration and Deputy Chairman of NFSC – asserts that many bankers who are also the owners of economic groups have the largest NPLs. “[I]n these banks, firms owned by the bankers themselves account for all mid- and long-term loans provided by these banks. They always search for debt conversion to keep their loans in the risk category 1 or 2. Through overlapping ownership, huge funds have been poured to private economic groups, as much as VND100,000 billion, or lower as VND40,000-50,000 billion, and many cases of VND5,000-7,000 billion while their assets are only VND1,000-2,000 billion. There is a tycoon-banker whose loans account for 43% of the bank equity... To evade the law, they borrow under the names of their children, nieces/nephews, relatives, or acquaintances so that banks, and even the SBV Inspectors, are not able to control. Only the Investigation Agency are able to verify.”\textsuperscript{117}

This a well-grounded statement, because overlapping ownership creates incentives for bank to ignore requirements on loan appraisal and customer supervision, as discussed in Section 2.2.4, as the banks’

\textsuperscript{116} Vũ Thành Tự Anh, Trần Thị Quế Giang, and Đỗ Thiên Anh Tuấn (2013).

\textsuperscript{117} Recited from Xuân Thu (2013), “Nước ngoài muốn mua nguyên lô nợ xấu” (Foreign countries want to buy entirely NPLs). Báo Sai Gon Tiếp thị, accessed on 29/10/2013 at http://sgtt.vn/Ban-doc/184370/Nuoc-ngoai-muon-%E2%80%9Cmua-nguyen-lo%E2%80%9D-no-xau.html
benefits are closely linked to their affiliated firms’ benefits, while risks spread over all shareholders, including minor and non-controlling shareholders.

The blood vessel of the economy is currently clogged with NPLs and resolution to NPLs is considered a central task that the SBV is undertaking. There are some doubts about the feasibility of bad debt resolution which is beyond the scope of this study. If overlapping ownership is presumably one among reasons for high NPLs in the banking system, resolution to NPLs requires that to overlapping ownership. In other words, resolution to NPLs should be accompanied by restructuring banks strongly and effectively, especially dealing with overlapping ownership by more tough and effective measures than what the government and the SBV are undertaking.

3.6.2. Dealing with weak banks for the time being

By the time of setting up bad debt management companies, the effort to restructure the banking system should focus on dealing with weak banks such that the government budget is not spent. First of all, weak banks have to restructure on their own if existing shareholders can contribute more capital. If they cannot afford to do so, restructuring should be done with the participation of outside investors by trading or M&A. Finally, if both alternatives are impossible, the government can assign outside institutions to engage in restructuring weak banks.

Complying with the principle of ‘the government budget is not spent,’ successful restructuring requires raising real money from the (domestic or foreign) private sector. If the real money from the private sector is not available while the trading or M&A is nominally done, virtual money from the private sector will be used. It means that restructuring weak banks will complicate and exacerbate the overlapping ownership, if not using overlapping ownership to restructure banks.

Since 2012, the SBV has identified 9 weak banks to be addressed. Some are dealt by means of trading or M&A, while the others are restructuring. Eight of nine banks have been resolved or approved the restructuring schemes, the remaining bank has no any action. It suggests that restructuring weak banks are going on very slowly. This not only reduces the efficiency of the weak bank restructuring but also hinders the process of restructuring the banking system in general. More importantly, in dealing with the weak banks, the overlapping ownership itself is deployed to address weak banks. Hence, in stead of actual restructuring to resolve liquidity problem and the bank weaknesses, the way the banks are now superficially dealt reinforces the overlapping ownership as some new groups come in. Letting new groups that have financial potentiality come in may improve liquidity in the short term, but it would lead to many consequences as same as those for the time being due to accumulated overlapping ownership.

New investors are expected to have financial potentiality to inject actual money into the troubled bank and hence, resolve temporarily the liquidity problem. However, in the context of economic downturn and high NPLs, the so-called clean money should be reconsidered. If the financial sources are not transparent, there is a danger that the overlapping ownership is a ground on which affiliated groups reinforce overlapping ownership itself based on ill-devised restructuring schemes. In other

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118 This section is partly taken from the policy paper Khởi thông những nút thắt thể chế để phục hồi tăng trưởng (Tapping institutional bottlenecks for growth rebound), VELP, 15/8/2013.
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words, letting new investors come in while dominant shareholdings or overlapping ownership is still intact cannot resolve current problems of the banking system in a sustainable way. Replacing a player with another one cannot radically resolve problems.

This can be firstly seen in the case of weak banks that have been dealt, namely, the merger of three banks – SCB, TNB, and FCB. Since they are owned by the same owner, the merger cannot resolve their NPLs and inherent weaknesses. In deed, after two years of merger, the financial condition of the merged bank is not much improved and no synergy is created since then.

Likewise, liquidity difficulties in banks such as TienPhong Bank (TPB) and TrustBank are the grounds for new investors like DOJI or Thien Thanh to engage in the banking sector and become strategic investors. According to DOJI assessment, when participating in TPB, DOJI and prospective investors have financially supported TienPhong Bank, increasing charter capital to VND5,550 billion to improve liquidity and overcome short-term difficulties in TPB. However, this group do not hide its plans to turn TPB into the “financial gate” for DOJI subunits. It is useful to note that while the SBV tries to keep banks from expose to gold, the participation of DOJI – a gold, silver, and jewelry trading group – is likely to expose TPB to gold as DOJI incorporates the gold trading business into the bank. Similarly, Thien Thanh Group, presumably the strategic partner who has financial potentiality and managerial competence, becomes the strategic shareholder in TrustBank. The financial potentiality is not mentioned for now, the expectations of managegial competence of Thien Thanh should be reconsidered. Certainly, this group has holdings in various firms in different sector, so TrustBank is at risk of becoming a “financial gate” for Thien Thanh, like TPB for DOJI.

For the merger of HDBank and DaiABank, among new members of DaiABank BOM is Savico Holdings, who is a founding member of Techcombank, VIB, and Vietjet Air. In addition, a group of shareholders in Savico Holdings also has shareholdings and holds important positions in HDBank. The recent merger of WesternBank and PVFC creates a problem in another form. While the Law on Fls tries to separate between banking and non-banking, this merger makes it hard to control the picture of financial activities.

The above examples suggest that the way the weak banks are currently dealt accidentally exacerbates the overlapping ownership. M&A or the participation of new investors who may have financial potentiality but no banking management experiences can hardly improve the managerial competence of banks. A commercial bank is a public corporation in essence. Therefore, as a principle of using M&A as a means of restructuring banks, the post-M&A banks should have an ownership structure of a public corporation. The ownership should be either more dispersed or extremely concentrated, i.e., there is only one owner, as in the case of foreign banks in Vietnam, in stead of simply replacing a player with another one.

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CHAPTER 4

POLICY RECOMMENDATIONS AND CONCLUSIONS

With the state of the ownership structure as depicted in Chapter 2, it is understandable that the cross ownership is blamed for all problems in the financial system. From the point of view of corporate governance, especially in the banking sector and in combination with the cross ownership experiences in the world, however, the actual cause of deficiencies in the Vietnamese banking system is not simply the cross ownership. If cross ownership is initially a tool for firms to link closely against being acquired and pyramidal ownership is an instrument for interest groups to capture power with unproportional capital commitments, then overlapping ownership is a combination of both piramidal ownership and horizontal linkage. Each model exerts its negative or positive consequences depending on the incentives created by the institutional environment that nurtures it. Furthermore, the consequences of piramidal, cross, and overlapping ownerships also depend on the nature of the legal or natural persons who take control of the ownership chain. Experiences from Japan, Germany, and other countries suggest that overlapping ownership was not built in a day with administrative regulations, and contrast, no any administrative regulations can immediately eliminate overlapping ownership or absolutely prohibit it. Cross ownership was purposely built in Japan and Germany in healthy institutional environments that were appropriate with it, leading to positive performance of the two economies for a long time. However, while advantages of the model did not remain a lot over time, its negative consequences were increasing. Recognizing the model drawbacks, Japanese and German politicians did not have any administrative commands or policies to allow a quick removal of overlapping ownership. Only when the economic and institutional contexts are not favorable for overlapping ownership, firms themselves decide to trim it off.

Overlapping ownership in Vietnam is a consequence of a series of wrong regulatory policies and becomes a tool for some interest groups to capture power and exert influence to secure personal profit. Characteristics of ownership structure of Vietnamese banking sector explain why overlapping ownership becomes an effective tool for interest groups to override the supervisory barrier of the financial system. Therefore, the research recommendations do not focus on how to eliminate cross ownership in Vietnamese banking system; rather, they address a more fundamental problem, i.e., how to improve the institutional environment, remove components of overlapping ownership that lead to disadvantages to the system. Based on analysis in Chapter 3, the presented theoretical framework and the international trend of CB supervision reflected in Basel Accord, we suggest four classes of policy recommendations to enhance the efficiency of supervisory authorities of Vietnamese financial system toward a more healthy and safer banking system. The first class of recommendations aims at mitigating interest conflicts between policymakers and those who are affected by the policies. The second class is to reduce the bankers’ moral hazard. The third wants to lessen the capture of power by interest groups through separating ownership and control. The last class of recommendations is some technical suggestions to improve current regulations on safe banking activities.
It is noticeable that these measures should be implemented in priorities following reasonable sequence to avoid from new deficiencies that arise when banks have to deal with new infeasible policies. Moreover, a holistic approach should be taken to implement measures because some fundamental ones should be carry out, otherwise the effectiveness of the others would be reduced or even neutralized, and hence, create incentives for new variations that jeopardize the system.

4.1. Mitigating interest conflicts by separating of ownership and supervision

4.1.1. Separating ownership and supervision by the SBV

The first fundamental measure to be implemented is to separate between the SBV’s ownership and its supervision over the banking system. The case of lending by BIDV to hydropower projects or Vinashin as discussed in Chapter 3 indicates the other side of the fact that SBV under the government’ direction lets SOCBs break the law on safe operations. In this regard, the SBV should be independent in supervising CBs. Accordingly, first of all, it is necessary to separate between its roles as both the representative of the owner and the regulator-supervisor over SOCBs. The model of Temasek Holdings in Singapore or the State Asset Management and Supervision Commission (of Council of National Affairs) in China can be useful references.

In principle, the representative of the bank owner should be responsible for decisions on capital allocation, organization, governance, and performance of the bank. For SOCBs that have gone public, decisions by the representative of the owner need to be approved by voting rights proportional to the shareholdings in the shareholders’ meetings. Financial and managerial information of banks should be publicly available at least as that of public JS CBs. As the supervisor, the SBV should ensure that SOCBs are operating in compliance with their corporate charters and current oversight regulations. Supervisory rules should ensure the objectivity, independence, and equity in compliance with the oversight framework for the financial system as a whole. At the central level, if the SBV is apart from SOCB ownership, it will be apart from ownership in many other JS CBs. This is very important to mitigate the interest conflicts between the regulator who makes policies of safe banking supervision and those who are affected by these policies. Eliminating the role of the SBV as an owner in the CBs is crucial to reduce the bankers’ moral hazard.

4.1.2. Reducing the shareholdings by the state in CBs

It is useful to notice that separating ownership and supervision is just a palliative because the Ministry of Finance and SBV are generally under the government’s centralized management. When ownership and supervision are not clearly separated, interest conflicts still arise and capital misallocation is still going on. The state, via Ministry of Finance, is the owner of both CBs and SOEs. Hence, the capital tends to go to the state-owned businesses, despite their weak performance. If the capital cannot flows to highly productive uses, the economy is hardly expected to be rapidly and sustainably growing. As shown in a large body of literature, the fact that the government takes the ownership right in the banks, directly or indirectly, does not benefit the banking system and the economy. Therefore, in the long term, keeping reducing the state ownership in SOCBs is prerequisite.

121 Within this study, we do not address the interest conflict at the micro level within the SBV due to not separating between ownership, execution, and supervision.
for not only securing the minor shareholders’ interests in the banks but also aiming at efficient allocation of resources to the economy as the whole. Not only the ownership relations between the SBV and SOCBs or the Ministry of Finance and SOCBs at the central level, but also various forms of ownership at lower levels, such as the state ownership with private JSCBs via legal persons, natural persons, or local government agencies needs to be minimized.

Reducing state ownership in SOCBs has at least 4 implications for governance, and hence, for SOCBs’ activities. First, it helps reduce the pressure of directed lending on SOCBs. Second, under the oversight by outside shareholders (not the government), SOCBs have to comply better with the SBV’s regulations. Reducing the state ownership enhances the role and the voice of private shareholders, who know how to allocate resources more efficiently for maximizing the bank asset value. Of course, the SBV still undertakes the supervisory function to ensure that banks are healthily operating, not overly profit-seeking and jeopardizing the banking system. When the state ownership reduces, SOEs competes the private sector for financing. Competition motivates SOEs to innovate to be more effective or go burst otherwise. The government should not protect weak firms with directed credit or implicit guarantee, because this nurtures the weaknesses and stagnation in SOCBs in particular and the government business in general.

For SOCBs, reducing state ownership also means an increase in the role of private ownership. Private shareholders have little shareholdings in equitized SOCBs. Therefore, they are not able or have no incentives to oversee the banks. When the state ownership is reduced, private shareholders are in a position and have incentives to carry out their supervisory function as the real owners, because their pay-off is proportional with their shareholdings in banks. Meanwhile, the SBV should improve safe banking regulations and independently supervise the compliance.

Third, reducing state ownership in CBs, including SOCBs and JSCBs, mitigates the interest conflicts between the central and local governments and those who are affected by the their supervision. A lot of research indicates that state ownership has negative impacts on the banking activities because the capital flows are used for the political purposes – buying votes from constituencies via approving capital appropriations to white elephant projects.

Fourth, reducing state ownership in CBs helps limit the bankers’ moral hazard. As long as banks can build, even indirectly, ownership affiliations with the government power, they go on having incautious behaviors in lending activities, making risky investment/lending decisions, because they can pass the buck to the state shareholder and expect the bail out from the government budget.

The government disinvestment from the banking system should be done in the healthily competitive and transparent environment. In early stages, to prevent from sudden market disturbances that have negative impacts on the bank values and avoid from tunneling the public assets to private hands, the government disinvestment from SOCBs and JSCBs can be done via SCIC. Shares can be sold for reasonable prices to strategic investors; on the other hand, if the bank stock prices are undervalued (due to excess supply, asymmetric information, or manipulation by interest groups for tunneling the public assets...), then SCIC can receive transferred shares, or buyback, holding the temporary ownership and sell them in the future.
4.2. Reducing moral hazard with market discipline

In relation to the agency problem, the moral hazard increases in the environment characterized by asymmetric information, high transaction costs, and weak sanctions. In contrast, it reduces significantly when the information is transparent, agents are closely supervised at low costs, and sanctions are stringent. The bankers’ moral hazard follows this pattern. On one hand, bankers rely on their ownership relations with the SBV, SOCBs, SOEs, local government agencies, and legal or natural persons that belong to the government. On the other hand, bankers are not put in the environment that forces them to disclose information and compete healthily, so they always find out loopholes of the law. Furthermore, bankers are willing to break the law if necessary because they are not likely to be found out or if they are, punishments are negligible compared to what they gain. The following suggested solutions aim at reducing these moral hazard behaviors.

4.2.1. Eliminating exceptions in complying with the supervisory framework

In supervising CBs – the deposit receiver – there should be no any exceptions to the compliance with the regulations on safe banking activities. SOCBs, like JSCBs, must be consistently subject to stringent supervision.

As discussed in Chapter 3, maintaining exceptions in supervising loans to SOEs and the state economic groups creates huge moral hazard in SOCBs because their losses from non-compliance would be bailed out by the government. This not only increases the public debt burden to the government but also creates an unhealthy and unlevelled playing field for different sectors. Bank loans to SOEs and the state economic groups require all qualifications and conditions for credit extension as private firms. In contrast, SOCBs themselves need to treat with SOEs like others, i.e., based on the financial capacity and performance of the firms or projects, rather than the relationship with and implicit guarantee by the government. To create incentives for SOCBs, banks should be responsible for their financial performance (such as the profit margin or NPLs) rather than social performance (like social security or poverty alleviation). Social performance should be undertaken by the government via public agencies that adopt social policies, rather than by SOCBs or SOEs. It is important to reduce the dominant state ownership so that private shareholders are more entitled to engage in making decisions of capital allocation in CBs. If SOEs are efficient, they will not need financing from SOCBs; rather, even private CBs will compete for approaching them. In contrast, directed lending, ignoring safe banking regulations, despite the SOEs’ financial performance, loads SOCBs with bad debt burden, affecting existing shareholders. In the economy, this devalues the banks and affects negatively the equitization of the remaining SOCBs and the disinvestment in partly-equitized SOCBs; these losses are ultimately borne by the government.

4.2.2. Eliminating the state ownership and the ownership by SOEs and groups in CBs

The first class of solutions to mitigating interest conflicts between the SBV, government agencies and the banking system also helps reduce the bankers’ moral hazard but it is not radically reduced. The case of ABB in Chapter 3 indicates negative impacts of the agency problem in SOEs that have overlapping ownership with CBs. Thanks to their shareholdings, SOEs are easily borrowing from CBs in which they have shareholdings. These loan transactions often violate the supervisory framework,
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or are even not subject to supervision. To prevent from non-stringent loan appraissal, uncommercial lending decisions, and NPLs, it is imperative to eliminate the state ownership and the ownership by SOEs and groups in CBs. Chapter 3 suggests that many SOEs now own banks and nearly all the state economic groups own at least one bank each. Meanwhile, the large shareholders in six of nine weak banks that need restructuring have direct or indirect ownership relations with the state. It is not worrying if a firm have shareholding in a bank in the form of investment shares (not sufficient to dominate executive decisions) for the purpose of diversification and enjoying capital gain. But in Vietnam, firms own banks not only for the profit-seeking purpose but also for the use of financial leverage in the banks to raise funds for their ease operations. Limited by the credit lines in the banks which they own, firms and banks create complicated overlapping ownership network and special financial products to drive the funds at the firms’ discretion. This leads to problems in the ownership structure and negative consequences of the financial system in Vietnam. When the state-owned economic groups and SOEs own JSCBs, the direct credit is extended to not only SOCBs but also JSCBs. Hence, eliminating the ownership by SOEs in CBs reduces not only the bankers’ moral hazard (relying on government’s bail out for directed credit and enjoying privilege for breaking the law) but also the incentives to affiliate and create overlapping ownership amongst firms and the financial system.

Recently, SOEs under the public and media pressure have announced their disinvestment. In fact, however, the disinvestment is delayed with the excuse of unfavorable market conditions. Japan encountered the same resistance when it impose restrictions on overlapping ownership in 2001. In response, the Banks’ Shareholdings Purchase Corporation (BSPC) was set up. Firms that violated the overlapping ownership restrictions had to disinvest by selling their shareholdings to BSPC, which in turn resold to outside investors in a certain sequence.

In 2009, SCIC bought Bao Viet Group shares from Vinashin. Therefore, to eliminate overlapping ownership among SOEs and JSCBs, SCIC can play the role of a buyer who purchases banks’ shareholdings from SOEs (including SOCBs). Recently, SCIC has been criticized for limited capacity to serve as the state capital manager. Thus, as long as SCIC’s capacity and authority are not significantly improved, this study only suggests a transfer of the banks’ capital from SOEs to SCIC. SCIC would hold banks’ shareholdings temporarily and resell them to outside investors in a certain sequence when the market conditions are favorable. It is noticeable that, with limited human resources, SCIC should be reformed to focus on capital management and representation of the state capital owner in groups and banks rather than spreading over both administration and capital management in hundreds of small SOEs.

4.2.3. Enhancing the market oversight

The roles of the government and regulatory agencies in controlling the financial system are undeniable due to its huge repercussions, posssitive and negative. However, with limited fiscal and human resources, the government should only focus on setting up good institutions that create

122 Mạnh Quân (2012).
healthy incentives to players, both natural and legal persons. All players are pursuing profit by
nature. Regulatory policies cannot and should not be expected to reduce this ambition; rather, they
should secure the institutional environment that encourages and rewards properly the players’
positive efforts and punishes self-interest pursuing behaviors causing negative externalities to the
market. To do so, it is necessary to (i) have serious sanctions so that players have to consider the
small benefits of non-compliance against the big losses of being blown with the whistle; (ii) provide
transparent, accurate, timely information to the market so that all shareholders who do not directly
take control of the firm can exercise their ownership with the support of institutional investors,
analysts, and organizations that protect small shareholders; and (iii) have regulatory and supervisory
regulations that create healthy competitive environment, with no biases and barriers to the players’
innovation and the market oversight over firms’ behaviors, such as acquisitions of badly managed
firms. The case of Sacombank is a typical example of the market oversight: when a bank is badly
managed, it is “punished” by the market through being acquired. However, it would be perfect if the
acquisition is transparently done in compliance with the market discipline. If the acquisition is carried
out in a non-transparent, or even non-compliant manner, as a bad result, a well-managed bank could
be acquired by an interest group such that it is unlikely to benefit the existing shareholders of the
acquired bank. Only if there is no exception to the compliance with safe banking regulations, banks
do not have ties to or rely on the SBV or SOEs, and they are operating in a transparent and level
playing field under the stringent supervision of competent authorities and the market, bankers’
moral hazard would be decreased.

4.3. Reducing the negative impacts of separation of ownership and control

In fact, when firms are growing and getting bigger, the separation of ownership and control is more
common in the world, including the U.S., U.K., Northern and Eastern Europe, and Asia. Separation of
ownership and control seems to be inevitable. In various institutional environments, it may lead to
interest conflicts between minor and major shareholders who take control of the firm, or between
dispersed shareholders with those who are employed to run the business. The most noticeable
consequence is the trading on this separation to capture power and dominate the managerial
decisions in a non-transparent manner in securing personal profit. This is not desirable and needs to
be reduced to prevent from negative externalities to other shareholders and the society as a whole.
The ownership structure of CBs in Vietnam suggests a very common separation of ownership and
control in which piramidal, overlapping, and even shadow ownerships are used to capture power in
the hands of a group of state and private shareholders including individuals, families, and private
groups. The financial resources they own are much less than the extent to which they can dominate
and manipulate the banks. This leads to the interest conflict between small shareholders and the
society as a whole and the interest groups that capture power and dominate
the banks’ executive
decisions. Thus, the third class of recommendations does not aim at eliminating the separation
of ownership and control; rather, it suggests policies to (i) restrict the power capture through dual
shares and pyramidal, overlapping, and shadow ownership, (ii) improve policies on information
disclosure and market oversight to capture exactly the ownership structure and governance of the
banking system and enhance the ultimate owners’ and controlling shareholders’ accountability.

125 In the discussion on the fourth class of recommendations, this study presents technical issues relating to
sanction and disclosure regulations in more details.
4.3.1. Respecting the “one share one vote” rule

The world experiences suggest that the capital markets are underdeveloped in most of civil law countries while their banks play a more important role in providing capital to firms. In this environment, firms are characterized by small sizes, concentrated ownership, and the salient role of families and private economic groups. Concentrated ownership has its own advantages and disadvantages. On one hand, concentrated ownership is a legitimate motive for investors who want to protect themselves in non-transparent investment environment in which shareholders’ interests are not protected. On the other hand, controlling shareholders may want to act in their own interests at the expense of minor shareholders. This is specially worrying when controlling shareholders use some tools to capture power unproportional with their capital commitments. Therefore, while the regulatory policies cannot absolutely prevent from concentrated ownership, they should aim at restricting violation of the “one share-one vote” rule. Regulatory and supervisory policies relating to the bank ownership should limit the use of dual shares and pyramidal, cross, or overlapping ownership to separate ownership and control, allowing natural and legal persons to capture power, dominate the market and pursue self-interest. To do so, the antitrust law, the requirement for declaration and control of ownership structure to capture exactly the ownership status of the system, and the restriction on domination by natural and legal persons using overlapping to capture power should be in place. If legal and natural persons find no benefit in overlapping ownership, or that benefit is not financially commensurate with their commitments (for example, strict taxation on gains from overlapping ownership) and the power from indirect ownership chains is restricted to the actual shareholdings, they will properly choose to increase or trim off overlapping ownership. In addition, policies that reduce transaction costs for small shareholders in exercising their ownership and more actively involving in overseeing large shareholders and those who are employed to run the banks should be in place. Some examples of these policies are regulations for distant voting or ease of delegation, or setting up organizations to protect small shareholders’ rights, and so on.

4.3.2. Increasing legitimacy and clarifying the ownership structure, ultimate owners, and accountability

Many problems of non-compliance with safe banking regulations as shown in Section 3.2.2 do not arise from the overlapping ownership itself. In most of cases, many negative consequences would be prevented should the definitions of “affiliated persons” and “groups of affiliated customers,” the disclosure requirement, and sanctions of non-compliance be strictly made. Current regulations on affiliated persons do not covered all cases in which overlapping ownerships are hidden. In fact, the following cases suggest the necessity of reconsidering the concept of affiliated persons. The first is the family and kinship ties. The case of ACB indicates, the wife of a large shareholder in the bank has additionally 4.99% shareholding in VietBank. This de facto allows ACB to take 14.99%, rather than 10% control as reported. Thus, a shareholder in the group of major shareholders in a bank should be considered its affiliated person. Second, the ownership relation between a shareholder and a firm also creates a channel by which the overlapping ownership amongst banks is established. For example, in counting the shareholding by Eximbank in Sacombank, the 5.17% shareholding by Saigon Exim

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126 See Section 2.4 on experiences from Japan and Germany of market regulation to restrict negative impacts of overlapping ownership.
Financial Investment JSC in Sacombank should be taken into account, because Saigon Exim is an affiliated firm of Eximbank and this bank is a founding shareholder of Saigon Exim. Third, overlapping ownership can be set up via labor relations (between a long time employee or the one who holds an important position in the firm and the firm owner), such as in the case of three-bank merger or ACB as illustrated in Section 0. The fact that ACB and its important BOD members (Deputy General Directors or Chief Accountant) have shareholdings in other banks allows ACB to increase its de facto shareholdings that is not against current regulations. In addition, this is the case in which Shareholder A in Firm B (let’s say, A has 25% shareholding in B) has shareholding in Bank C. Mr. D, a Board member in B, has shareholding in Bank C as well. In this case, D should be considered an person affiliated with A. Since overlapping ownership arises from these three relationships, it is necessary to broaden the concept of affiliated persons to find out the ultimate owners in banks. The fourth is economic relations, such as the partnership between suppliers and buyers, delegation of investment and business, and even contract loans. This is the case of a firm borrowing from a bank, and both of them have shareholdings in another bank/firm. In this case, the borrower (firm) can be dominated by the lender (bank) to wield influence on the bank/firm being owned. The fifth is social relations; for example, two people who are acquainted or used to cooperate at least once in doing business, setting up a firm, or making investment in a project should be considered affiliated persons. This concept is quite vague and needs to be further discussed, but it should be kept in mind given the Vietnamese cultural context. It is important to have a clear definition of social relations.

To determine accurately the banking ownership structure, in addition to broadening the concept of affiliated persons, it is necessary to reduce the shareholding at which owners have to disclose their information. This helps the SBV know the shareholdings in banks by each shareholder or group of shareholders. By current law, institutions, individuals, groups of affiliated persons who have 5% or more voting shareholdings have to report their shareholdings to regulatory authorities. However, since an individual is not allowed to have more than 5% of charter capital in a CB, few individual shareholders in banks disclose their ownership information. By splitting over 10 affiliated persons such that each holds 4.99%, shareholder X, the ultimate owner with 49.9% shareholding in Bank Y can take control of it. Practice so far shows that many shareholders have just less than 5%, i.e. 4.99% holding, sufficiently not to disclose information. The Law on FIs of 2010 provides that an individual shareholder is not allowed to own more than 5% of the bank charter capital, while this figure is also the limit at which shareholders in public corporations have to disclose information. Clearly, with this provision, the law ignores a lot of, if not all, bank shareholders who do not have to disclose information. Restriction of 5% shareholding to be disclosed may be proper for a public corporation, not necessarily for a public bank. A bank has a very large equity, so 5% shareholding by an individual represents a very big amount. Thus, the Law on FIs should redetermine the shareholding threshold subject to disclosure requirement in conformity with the banking oversight framework, in stead of the generic approach to other public corporations.

Hence, to know who are the ultimate owners in a JSCB, the government should (i) redefine the affiliated persons in the Law on FIs; and (ii) provide for the information disclosure by affiliated

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persons of a bank shareholder. Accordingly, affiliated persons of a bank shareholder have to disclose information when they have, say, 1% shareholding, or VND30 billion face value, or more of the minimum bank equity. In practice, most of JSCBs have VND5000 billion equity, shareholders who own VND50 billion or more of the charter capital have to disclose holding information. Given this equity value, the costs of transaction incurred due to new regulations on disclosure are not relatively large.

The case of STB indicates the role of Eximland Corporation and SDI, affiliated firms of Eximbank, in creating overlapping ownership amongst banks. Currently, they are governed by the Law on Enterprises while their operations tend to be those of a financial investment fund that should be supervised by SSC under the Law on Securities. As analyzed in Chapter 3, shareholders in these firms can manipulate the banks’ activities or loophole the safe banking regulation. Experience from the U.S. about firms that own banks (Bank Holding Company Act of 1956) can be applied for their sanctions. In the U.S., Fed is responsible for capital supervision, approval of trading and M&A, and inspection of bank holding companies. In Vietnam, the following institutional shareholders are supervised by the SBV like FIs: (i) those who have 5% shareholdings or more of a bank, or (ii) affiliated persons/firms of a group of shareholders who have 5% shareholdings or more of a bank. For now, when the National Assembly have not created such a law, the Law on FIs should have a supplemented chapter to provide for the SBV supervision of bank holding companies.

The bank leaders’ accountability is also noteworthy. Those in whose name a bank is owned should be accountable in front of the supervisory agencies for their funds. Large shareholders or those who are authorized to run a bank should be accountable in front of other, especially the small, shareholders, for the bank performance. Overlapping ownership can be improved when responsibilities of the bank leaders, managers, and supervisors are well defined in supervisory regulations and internal bank governance rules. While clear, transparent, strict regulations are necessary to supervise the bank leaders’ compliance, shareholders, especially the small ones, should be provided with up-to-date adequate information and convenient mechanism with which they can oversee and evaluate the financial performance of those who are authorized to run the firm. When the legitimacy, ownership structure, and the ultimate owners are clarified, benefits from using overlapping and shadow ownerships to capture power and loophole regulations would be negligible, or even overlapping ownership incurs costs of compliance. Owners themselves would consider disinvestment to invest concentratively in a bank or restructuring via M&A to reduce overlapping ownership. Banks that have the same owners tend to merge. The merger of Saigon Commercial Bank (SCB), TinNghiaBank (TNB), and Ficombank (FCB) mentioned in Chapter 3 is an illustration of the feasibility of this solution. However, this is only the first step of restructuring banks that have the same ultimate owners via M&A. The next important step is to resolve the merged bank’s bad assets. To ensure efficiently restructuring, the M&A of banks should be carried out in a transparent manner. When a merger or acquisition is completed, information on the ultimate owners should be disclosed. M&A

129 The second class of recommendations discusses two points in more details.
130 Pursuant to Decree 141, having 5% shareholding in a bank requires an investment of at least VND150 billion in terms of face value.
need to be encouraged and supported in one of two ways. First, the ownership of the merged banks should be more dispersed; or second, in case of acquisitions with the ownership of the acquiring banks is less dispersed, the roles of strategic investors should be secured to aim at: (i) cleaning up and resolving NPLs and bad assets; (ii) innovating and enhancing the efficiency of the banking governance; (iii) transferring hard and soft technologies to the bank.

4.4. Improving safe banking regulations

In addition to the underlying issues relating to the ownership structure of the banking system as above mentioned, an important reason for banking problems and non-compliance is the deficiencies and loopholes of law. Overlapping ownership arises for the large part from Regulation 141 on the legal capital. Unclear ownership and non-compliance with credit and capital contribution limits are partly due to inadequate regulations on affiliated persons and disclosure. Although regulatory agencies have great efforts to revise regulations toward approaching international practices, the discussion in Chapter 3 shows that (i) in many cases, regulations have “deliberate” loopholes to induce the banks’ relations with regulatory agencies to ask for exceptions, (ii) some regulations are inadequate, creating grounds for bank to loophole the law, (iii) some regulations are inconsistent and incoherent amongst themselves, so banks search to deal with them; their implementation is not based on the same accounting standards, thus interpretation of data is distorted. The fourth class of recommendations addresses technical issues though not in a comprehensive way; priority is given to some important issues.

4.4.1. Banking supervision based on CAR rather than the equity requirement

As shown in Section 3.3.1, safe banking standards are specified in the Law on FIs and some supporting documents like Circular 13, Circular 19 (amending Circular 13), and Circular 22 (amending Circulars 13 and 19). It is noticeable that Circular 13 was made based on the Law on FIs amended in 2004, while the latest Law on FIs of 2010 has some important amendments from that of 2004. Regarding safe banking regulations, some provisions in Circular 13 have not been compatible with the Law on FIs of 2010 and not been revised. In addition, the approach of Circular 13 is mainly based on Basel I (1988) and has a little flavor of Basel II (2004), while the latest Basel III (2010)\textsuperscript{133} that is assessed as very serious and stringent has just been adopted by many countries.\textsuperscript{134} Clearly, upgrading safe standards is very important and needs to be continuously carried out in a well-prepared sequence even if the banking system is not in trouble. Although adopting more stringent standards may increase the costs of compliance for banks and the central bank’s supervisory capacity, it is worth adopting, given the costs of bankruptcy or the banking crisis due to non-compliance.

As shown in the beginning part of this study, the Vietnamese banking system has been rapidly developing in the last decade. Extensive integration and the presence of foreign banks require Vietnam’s constant upgrade of banking standards. This is an inevitable requirement even if the banking system is not in trouble. However, in fact, banks are facing a lot of problems, such as illiquidity, high NPLs, weak governance, moral hazard, and especially overlapping ownership.

\textsuperscript{133} Basel III is recommended to start adoption from 1/2013 and finish in late 2018.

\textsuperscript{134} Some countries in the region has begun approaching Basel III such as Singapore, Thailand, the Philippines, and Malaysia.
Complicated overlapping ownership neutralizes safe banking regulations and contributes to financial unstabilities and systematic risk on one hand, and indicates how current regulations are helpless in supervising effectively and efficiently the safe banking activities on the other hand. Hence, safe banking regulations need to be comprehensively upgraded to higher standards. This argument does not mean that this study is going to shows technical solutions in details; in stead, for its purposes, this report basically makes principled recommendations that help discourage or at least supervise overlapping ownership which is very complicated in the banking sector, contributing to strengthen the banking sector in particular and the financial system in general.

At present, the minimum equity is required for an FI in both absolute and relative terms in Decree 141 and Circular 13, respectively. The legal capital requirement for FIs in Decree 141 has little implication on securing financial safety and capacity of FIs. In fact, some analyses have pointed out that this requirement itself has contributed to creating problems for the banking systems recently. International practice also shows that the financial health of a bank is not measured by its equity in absolute terms; more important is its equity relative to its assets and liabilities. In other words, a JSCB that fails to meet the VND3000 billion equity requirement equity by current law may not be of weak financial capacity. It is important to compare its equity with its assets and liabilities. That is why Basel Committee has issued the rule of minimum equity that many countries, including Vietnam, adopt for their banking sectors with various specific standards.

It implies that the government should not “upgrade” the banking system with a decision similar to Decree 141 in the future; instead, the approach should be changed toward Basel II and Basel III. In particular, the CAR requirement in Circular 13 should be improved toward Basel II CAR. This requirement has been widely discussed but the specific provision remains in Circular 13. Problems in the banking system indicate deficiencies of this regulation. As discussed in Section 0, some banks with CARs as high as above 30% are actually facing illiquidity problem in particular and financial difficulty in general. It is not because CAR per se does not work; rather, (i) provisions of CAR in Circular 13 reveal inadequacies and need to be upgraded, and (ii) calculation of CAR is not reliable and not verified by SBV inspectors.

### Table 4.1. Minimum capital requirements by Basel III (effective as of 1/1, percentage)

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<tbody>
<tr>
<td>Minimum common equity</td>
<td>3.5</td>
<td>4.0</td>
<td>4.5</td>
<td>4.5</td>
<td>4.5</td>
<td>4.5</td>
<td>4.5</td>
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<tr>
<td>Capital conservation buffer</td>
<td>0.0625</td>
<td>1.25</td>
<td>1.875</td>
<td>2.5</td>
<td>2.5</td>
<td>2.5</td>
<td>2.5</td>
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<tr>
<td>Total minimum capital plus buffer</td>
<td>8.0</td>
<td>8.0</td>
<td>8.0</td>
<td>8.625</td>
<td>9.25</td>
<td>9.875</td>
<td>10.5</td>
<td>10.5</td>
<td>10.5</td>
</tr>
<tr>
<td>Minimum countercyclical buffer</td>
<td>0.0625</td>
<td>1.25</td>
<td>1.875</td>
<td>2.5</td>
<td>2.5</td>
<td>2.5</td>
<td>2.5</td>
<td>2.5</td>
<td>2.5</td>
</tr>
<tr>
<td>Total minimum capital plus capital buffer plus countercyclical buffer</td>
<td>13.0</td>
<td>13.0</td>
<td>13.0</td>
<td>13.0</td>
<td>13.0</td>
<td>13.0</td>
<td>13.0</td>
<td>13.0</td>
<td>13.0</td>
</tr>
<tr>
<td>Minimum Tier-1 Equity</td>
<td>4.5</td>
<td>5.5</td>
<td>6.0</td>
<td>6.0</td>
<td>6.0</td>
<td>6.0</td>
<td>6.0</td>
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**Note:**

- a Liquidity coverage ratio: early operation stage
- b Leverage ratio: tracking, monitoring
- c Leverage ratio: parallel working 1/1/2013 - 1/1/2017

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135 FETP 2013.
Hence, the SBV has two big things to do. First, quickly upgrades CAR provisions in Circular 13, and second, verifies the banks’ calculation of CAR. Relating to CAR, the requirement of 9% equity to total risky assets is still relevant in current conditions. However, it is important to refine this provision, namely, safe limits on Tier-1 and Tier-2 capital in the spirit of Basel II, including revisions in Basel III, should be in place.

4.4.2. Quickly improving new safe banking ratios as required by the Law on FIs of 2010 in the spirit of Basel II toward Basel III

In addition to CAR, other safe banking ratios in Circular 13 – such as limits on capital contributions and equity purchases; limits on credit extension to groups of affiliated persons; and limits on capital uses and loans to financial and securities investments – need to be adjusted to the Law on FIs of 2010 and new conditions. BSIA has been very inactive in supervising and dealing with non-compliance partly because regulations are inadequate and out of date. To create legal grounds for banking inspection and supervision, regulations on banking activities in general and safe banking in particular need to be quickly improved and adopted. The ongoing restructuring strategy needs to address meeting standards and modern pattern of banking supervision that have been adopted all over the world (see Figure 4.1.), in stead of out of date banking supervisory regulations in Vietnam today.

Improving safe banking regulations not only aims at reducing motivation of overlapping ownership amongst banks and between banks and firms, but also redirects the banking system toward better safe standards, meeting the requirements for enhancing competitiveness and international integration. Once banks have well met requirements of safe operations, negative impacts of overlapping ownership and overlapping investments are reduced, even positive sides of overlapping ownership are exerted. Experiences in Japan show how overlapping ownership in Japanese banking system played an active role and contributed to achieving objectives of industry policies in 1950-1970. However, it is useful to recognize that the context of industry policy now is different in Japan and its institutional conditions are also different from Vietnam’s. Vietnam is not necessary to go on the same industrialization path as Japan does or design the Japanese-style financial system of Main Bank. Instead, what needs to be done now for the Vietnamese banking system is to improve promptly safe banking regulations to create legal grounds for banking supervision and inspection and constitute the technical foundations for restructuring the banking system toward more health and efficiency.

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4 Liquidity coverage ratio: introduction to minimum standards

Source: Basel Committee on Banking Supervision.
Cross Ownership of Financial Institutions and Corporations in Vietnam

Figure 4.1. The framework of Basel III

Source: Moody’s Analytics.

4.4.3. Capital audit to determine equity

As shown in Section 0, overlapping ownership can create the virtual capital in banks, making it hard to evaluate exactly their financial capacity, especially their actual equity. Since equity is an important basis on which other safe banking limits – such as credit limit, asset growth limit (via CAR), and limit on capital contribution/equity purchase – are determined. If equity is not accurately calculated, other safe banking criteria based on equity are of no value. Hence, it is important for the SBV to audit the bank equity and determine where it comes from. The Law on FIs defines equity as including real value of the bank charter capital and reserve funds, such as charter capital supplement fund. Based on this legal ground, SBV needs to audit and adjust, if any, the real values of equity and funds so as to evaluate the actual equity capacity of each bank.

In auditing capital, it is important to determine equity based on right its definition, i.e., its sources should enhance the bank’s actual financial capacity and long term stability (in relation to the long term nature of equity). For example, Circular 40/2011/TT-NHNN,\(^{136}\) whose legal foundation is the Law on FIs of 2010, provides that institutions and individuals are not allowed to use trusted capital or loans from other institutions/individuals to make capital contribution to banks.\(^{137}\) This provision is

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\(^{136}\) See Article 9, Circular 40/2011/TT-NHNN dated 15/12/2011 issued by SBV on licensing and organizing activities of commercial banks, foreign bank branches, representative offices of foreign FIs, and other foreign organizations that have banking activities in Vietnam.

\(^{137}\) It is noteworthy that Circular 40 is applied for newly established banks. However, it should be applied for all banks that are operating.
relevant to eliminate the use of unstable capital to make up the bank equity. Section 4, Article 55 of Law on FIs of 2010, however, specifies that shareholding by an individual/institution in a FI includes capital delegated to another individual/institution to buy shares. Although this provision helps broaden definition of shareholding in FIs by an institution (15%) or an individual (5%), the inconsistency makes it hard to apply the law in practice, and in deed, the regulatory agencies are likely to ignore it. For this implication, capital audit should focus on where the bank equity comes from, and parts of equity coming from trusted capital and loans to individuals/institutions to purchase bank shares that exceed a certain ratio have to be removed from the bank equity. The SBV should be entitled to trace back to the cash flows used by shareholders to purchase bank shares, if necessary. In other words, shareholders should be obliged to clarify, if necessary, where the money they have used to buy shares comes from. When that money comes from loans or trusted capital, shareholders are obliged to disinvest from banks in compliance with the Law on FIs.

Similarly, capital invested by a financial institution in another one or its subsidiary in the form of capital contribution/equity purchase and investments in this form to take control of firms that are operating in the banking, insurance, and securities sectors have to be removed from equity when financial ratios are calculated in compliance with the Law on FIs (Section 4, Article 130). Upon capital audit, in case a capital reduction arises, the bank has to recalculate its ratios based on the new equity and have plans approved by SBV to raise equity and/or reduce assets and other limit criteria to secure the safe banking ratios as required by law.

It is useful to make mention of NPLs in relation to the determination of bank equity. No one, even BSIA, knows exactly the NPLs in banks. Since NPLs reported by banks are so low, risk provisions are insufficient. If NPLs are more truly redetermined, such as in the light of Circular 02, risk provisions will be higher, and hence, bank profits will be reduced. Reduced profits mean decreases in both provision funds made by banks and retained earnings as part of equity. In this case, the SBV should have measures to resolve NPLs in the banking restructuring scheme. First, NPLs should be more truly revalued, and then banks would have to make sufficient risk provisions. Accordingly, banks’ reserve funds would be readjusted. If there are decreases in reserve funds, decreases in equity should be recorded for better evaluation of the bank equity capacity. Safe banking ratios based on equity should be readjusted to reflect better the financial risks facing banks. Capital audit, or banking audit in general, includes audit of not only financial statements but also operations and compliance. That should be done via independent audit to capture the actual financial conditions of banks, and hence, diagnose accurately their financial diseases as grounds for well-designed banking restructuring schemes and proper resolutions such that their costs and fiscal burden would be negligible.

4.4.4. Redefining the concept of affiliated persons

The concept of affiliated persons as specified in the Law of FIs should be redefined based on consistency with the way they are defined in the Law on Securities and the Law on Enterprises as shown in Box 3.1. However, the concept of affiliated subjects in the banking system should be broadly understood and cover not only family and kinship ties but also business, labor, and social relations, among which family and labor relations are relevant to both individuals and institutions. As discussed in Section 0 on theoretical overview of ownership, although A does not directly own C, A can take control of C via its ownership relation with B, then A and C should be identified as affiliated
subjects. This relation should be clarified in more details, though basically they can exert influence and dominate over each other or potentially make affiliations to wield influence, and hence should be identified as affiliated subjects.

Supervisory agencies in general and banks in particular should shift away from the concept of affiliated persons to that of affiliated subjects that are not only natural but also legal persons. Also, banking supervision should be based on not only ownership right but also control right. As shown in Section 0, a shareholder who has low shareholding in a firm can take control of it via complicated ownership structure; in contrast, another shareholder who has quite large shareholding in the firm may not be able to take control of it. In other words, research shows a separation of ownership (voting or cash flow right) and control. Hence, it is useful to deploy tools to measure the control\textsuperscript{138} in addition to the traditional measures of ownership so as to supervise effectively the governance environment of firms in general and CBs in particular.

4.4.5. Disclosure requirements

Disclosure requirements specified in the Law on FIs, Law on Securities, Law on Enterprises, and other related regulations\textsuperscript{139} need succession and compliance, though they should be improved and adjusted to the banking supervisory framework. Detailed provisions of subjects, contents, and scope of disclosure – especially for governance reports, financial statements, annual reports, shareholders’ meeting minutes, issue offers, and the use of proceeds from securities sales – in Circular 52/2012/TT-BTC of 2012 by Ministry of Finance are meaningful. However, as a drawback of the requirement for the governance report content disclosure, transactions and ownership by large shareholders and affiliated persons are not covered, while the disclosure requirement for institutions/individuals/groups of affiliated persons who have 5% or more of voting shares in a public corporation may not be appropriate for a bank, as above discussed. Thus, for now, the SBV should ask the Ministry of Finance to require additionally the following subjects as those who have to disclose information: (i) Shareholders who have 1% shareholdings or more in JSCBs; (ii) Person affiliated with shareholders who have 1% shareholdings or more in JSCBs. The SBV should also reserve the right to ask institutions/individuals/affiliated persons to disclose information in some cases to meet the banking supervisory requirements and ensure the transparency at the request of groups of shareholders, especially small shareholders in the bank.

4.4.6. Securing the radical compliance and effective sanctions

Upon audit and disclosure, BSIA would know the ultimate owners’ shareholdings. Accordingly, those who do not comply with shareholding requirements including\textsuperscript{140} (i) individual shareholders (5%), (ii) institutional shareholders (15%), (iii) shareholders and their affiliated persons (20%) have to resell their shareholdings to meet the requirements. Non-compliance should be strictly treated in conformity with law and absolutely not be ignored due to the fear of its impacts on the banking stability.

\textsuperscript{138} Such as the Banzhaf Index as introduced in Section 0.

\textsuperscript{139} See details in Circular 52/2012/TT-BTC by Ministry of Finance dated 05/04/2012 on guidelines of information disclosure in the securities market.

\textsuperscript{140} Law on FIs of 2010, Article 55.
Recommendations on broadening the definition of affiliated persons and reducing the shareholding threshold subject to disclosure requirement would increase the costs to society. In fact, shareholders in 40 CBs would be hit by this requirement. Second, this is a feasible solution to limit impacts of overlapping ownership on the banking sector in the current settings. Therefore, the increased social costs are necessary and not too big. Limiting impacts of overlapping ownership would enhance the effectiveness of banking supervision, and hence, contribute to creating a safe commercial banking system to finance the economy efficiently. Finally, penalties/fines for non-compliance with disclosure requirement should be higher to enhance the efficiency of sanctions.

4.4.7. Enlarging the supervision over large bank shareholders

First of all, the SBV should be entitled to supervise large institutional shareholders in banks including: (i) institutions having 5% shareholdings or more in a bank, or (ii) institutions/firms affiliated with a group of shareholders who have 5% shareholdings or more in a bank. In case these shareholders are insurance companies, securities companies, or capital investment funds that fall outside the BSIA’s jurisdiction, the SBV should closely coordinate with Ministry of Finance, represented by SSC and Insurance Supervisory Authority, to share supervisory information.

The SBV also needs to strengthen its supervisory capacity over groups of individual and institutional shareholders who are not covered in the definition of affiliated persons, but with their shareholdings, can be potentially affiliated and take control of banks.

4.5. Conclusion

Since late 2006, the Vietnamese economy had started acceleration. The securities market was enjoying a boom to be prepared for effects of international economic integration. At the same time, the financial-banking sector was experiencing increases in capital, loans, assets, and operation networks to meet the new competitive forces of the integration era. Also, many SOEs were upgraded to economic groups and allowed to expand in multidiscipline business, including financial-banking sector. Meanwhile, in addition to the wave of setting up bank branches, licensing was resumed after a long break, leading to the advent of new banks, domestic and foreign.

Also since late 2006, the government has recognized the need for strong banks to meet the requirement for integration and competition. The idea of a strong bank, however, was quite simple, mainly based on the equity, leading to the promulgation of Decree 141 on legal capital requirement for FIs. In practice of international banking governance and supervision, a bank with the largest equity does not always has the strongest financial capacity. Also importantly, an increase in the size requires an accompanying increase in the banking governance capacity and the supervisory system. Decree 141 does not impose the requirement for an increase in the banking governance capacity; furthermore, the required legal capital had to be reached within a short time frame while the financial-banking supervisory system was still deficient and limited. The banking supervisory framework had not been upgraded until 2010 under Circular 13 but its approach was still based on Basel Accord I of 1988.
Since 2008, after a time of overheating and asset bubble leading to high prices, the SBV has adopted urgent measures to control inflation. In this setting, the securities market entered into a bust and stock issues for capital raise by banks were getting more difficult. When the deadline (late 2008) of legal capital requirement was looming, loopholing behaviors of banks became more “creative”. Tricks of virtual capital raise were deployed to comply with the legal capital requirement while complicated ownership was created to avoid from the SBV’s supervision.

Our research shows that the current ownership structure in the Vietnamese banks and between banks and economic organizations is overlapping ownership, i.e. including both pyramidal (mainly) and cross ownership. Both pyramidal and cross ownerships have their own advantages and disadvantages. Japanese experience shows that cross ownership was a feature and played an important role in the industrialization policy in Japan during 1950-1970. However, it should not be confused between the critical role of cross ownership and the success of Japanese industrialization. It is important that Japan has designed a proper industrialization policy in the domestic economic conditions and the international economic setting at that time. It is similar with the case of Germany. Meanwhile, the case of Italy shows how cross ownership contributed to the weakening of the financial sector in the context of Italy’s accession to EU with very high competitive standards. The case of China is still controversial based on benefits and risks of cross ownership for the financial system and economic development policy in China.

For Vietnam, since the industry policy is now unclear, the Janaese-style use of cross ownership for the industrialization purposes is very risky, if not failed. Meanwhile, as shown in this study, overlapping ownership in the banking system accompanied by institutional factors has facilitated the banks’ loopholing, creating a lot of negative impacts on capital allocation and the systematic risks. The negative catalytic factors include (i) the ownership by SBV, SOCBs, and government agencies in the banking system, (ii) the ownership by SOEs and state-owned economic groups in the banking system, (iii) the ownership structure allows interest groups to maintain their grips on power and secure personal profit, while (iv) the legal system has a lot of loopholes and is not strict. High NPLs in the banking system that the SBV has been dealing with arise partly from these factors.

This study identifies the following fundamental reasons for problems in the banking system: (i) the interest conflicts occurs when policymakers are the owners of those who are governed by the policies and when SOEs are both the bank owners and those who have demands for bank loans; (ii) the moral hazard occurs when most of banks have relationship with regulatory agencies and rely on the government’s implicit guarantee; the moral hazard occurs when sanctions are weak and not strict and the law leaves a lot of loopholes and exceptions; and (iii) weaknesses in legal regulations facilitate the banks’ loopholing behaviors and/or make them resourceful; therefore, governance is harder and riskier.

Based on these analyses and observations, the authors make some recommendations that focus on: (i) separating ownership and regulatory function over CBs (including SOCBs and JSCBs) by BSIA; reducing the state ownership in SOCBs and JSCBs in the long term by transferring shareholdings to a state capital investment corporation that is professional, independent, and highly accountable; (ii) eliminating ownership by SOEs and state-owned economic groups in JSCBs, especially focusing on removal of exceptions to compliance with Law on FIs; (iii) strengthening oversight power of market
discipline through transparency and “one share one vote” rule, and (iv) improving safe banking regulations toward international banking standards as specified in Basel Accord, especially improving the CAR requirement and firstly auditing FIs’ equity; reducing the shareholding threshold subject to disclosure requirement; redefining broadly and tightly the concept of affiliated persons; revising the disclosure requirements; expanding the SBV’s rights to supervise bankers; and enhancing the effectiveness and efficiency of sanctions.

The above recommendations are confined to oriented proposals and technical suggestions and not sufficient. In the future, it is necessary to conduct research in depth on banking governance at both macro level (for regulatory agencies) and micro level (for banks), especially important are risk management and other aspects relating to the banking management (structure of banking ownership; establishment, organization, operation, and responsibilities of BOM…).

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## APPENDIX

### Appendix 1. Types of FIs in Vietnam

<table>
<thead>
<tr>
<th>TT</th>
<th>Types of FIs</th>
<th>1991</th>
<th>2001</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>SOCBs</td>
<td>4</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>2</td>
<td>Policy banks</td>
<td></td>
<td></td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>3</td>
<td>Development banks</td>
<td></td>
<td></td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>4</td>
<td>JSCBs</td>
<td>4</td>
<td>39</td>
<td>37</td>
<td>35</td>
<td>34&lt;sup&gt;[1]&lt;/sup&gt;</td>
</tr>
<tr>
<td>5</td>
<td>Join venture banks</td>
<td>1</td>
<td>4</td>
<td>5</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>6</td>
<td>Foreign bank branches</td>
<td></td>
<td></td>
<td>48</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>7</td>
<td>100% foreign capital banks</td>
<td>0</td>
<td>0</td>
<td>5</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>8</td>
<td>Finance companies</td>
<td></td>
<td></td>
<td>17</td>
<td>18</td>
<td>17</td>
</tr>
<tr>
<td>9</td>
<td>Financial lease companies</td>
<td></td>
<td></td>
<td>13</td>
<td>12</td>
<td>17</td>
</tr>
<tr>
<td>10</td>
<td>Central people’s credit funds/Cooperative banks&lt;sup&gt;[2]&lt;/sup&gt;</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Local people’s credit funds</td>
<td>1057</td>
<td>1095</td>
<td>1132</td>
<td></td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>Microfinance institutions</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>13</td>
<td>Representative offices of foreign banks</td>
<td>48</td>
<td>50</td>
<td>50</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Note:**

<sup>[1]</sup> The number of JSCBs was 37 in late 2010, reduced to 35 in late 2011 after SCB, TNB, and FCB had merged. In 2012, Habubank merged to SHB, so the number of JSCBs was 34.

<sup>[2]</sup> Since 6/2013, central people’s credit funds have become cooperative banks.

**Source:** SBV and compiled by the authors.
Appendix 2. Legal capital requirement for FIs

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. SOCBs</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agribank</td>
<td>2200</td>
<td>3000</td>
<td>3000</td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td>1100</td>
<td>3000</td>
<td>3000</td>
<td></td>
</tr>
<tr>
<td><strong>2. Urban JSCBs</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ho Chi Minh City</td>
<td>150</td>
<td>70</td>
<td>1000</td>
<td>3000</td>
</tr>
<tr>
<td>Ha Noi</td>
<td>100</td>
<td>70</td>
<td>1000</td>
<td>3000</td>
</tr>
<tr>
<td>Other cities/provinces</td>
<td>50</td>
<td>50</td>
<td>1000</td>
<td>3000</td>
</tr>
<tr>
<td><strong>3. Rural JSCBs</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>With branches</td>
<td>10</td>
<td>5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>No branches</td>
<td>3</td>
<td>5</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source:* Decision 67, Decree 82, and Decree 141.
Appendix 3. Regulations on debt classification and risk provision

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
<th>Decision 493 and Decision 18 (Quantitative method)</th>
<th>Article 7 (Qualitative method)</th>
<th>Risk provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cat. 1</td>
<td>Pass</td>
<td>Debts that are not due or less than 10 days overdue, assessed to be collectible with both principal and interest (including overdue principal and interest).</td>
<td>Debts assessed to be collectible with both principal and interest in full and in a timely manner.</td>
<td>0% 0.75%</td>
</tr>
<tr>
<td>Cat. 2</td>
<td>Special-attention</td>
<td>- Debts of 10 days to 90 days overdue;</td>
<td>Debts assessed to be collectible with both principal and interest, but borrowers reveal signs of weakening solvency.</td>
<td>5% 0.75%</td>
</tr>
<tr>
<td>Cat. 3</td>
<td>Sub-standard</td>
<td>- Debts of 91 days to 180 days overdue;</td>
<td>Debts assessed to be uncollectible of both principal and interest in a timely manner and some loss of principal and interest is possible.</td>
<td>20% 0.75%</td>
</tr>
<tr>
<td>Cat. 4</td>
<td>Doubtful</td>
<td>- Debts of 181 days to 360 days overdue;</td>
<td>Debts assessed to be very likely to incur loss.</td>
<td>50% 0.75%</td>
</tr>
<tr>
<td>Cat. 5</td>
<td>Loss</td>
<td>- Debts of more than 360 days overdue;</td>
<td>Debts assessed to be uncollectible.</td>
<td>100% 0%</td>
</tr>
</tbody>
</table>
- The 1st-time restructured debts that are more than 90 days overdue based on the first-time rescheduling;
- The 2nd-time restructured debts that are overdue based on the 2nd-time rescheduling;
- Debts that are restructured for the 3rd time onward, including those are not due or overdue;
- Deferred debts; debts to be resolved.
Appendix 4. Safe banking regulations in Vietnam

A. Regulation on bank equity

Charter capital is contributed by shareholders. This is shareholders’ limited liability to share risks in the bank’s monetary business. Due to problems arising from the agency cost of debt in banking activities, many countries require the minimum capital (legal capital) for CBs, accordingly, bank charter capital has to be higher than the legal capital. Bank capital is the backup financial source to cover risks incurred in CBs’ business activities. Since 2011, as required by the Vietnamese government, charter capital in a JSCB or SOCB is not allowed to be less than VND3000 billion.

Toward the international supervision standards in Basel Accord, besides the minimum charter capital requirement, State Bank of Vietnam (SBV) put forth a new requirement on capital adequacy ratios (CAR) including separate CAR and consolidated CAR. According to current regulations, assets are grouped into various risk categories from 0% to 250%. Safe assets have 0% risk while the riskiest assets, including loans to securities investments or real estate businesses, have 250% risk. Also, the equity is split into Tier 1 and Tier 2 with well-defined compositions. Since October 2010, CBs have been required to maintain CAR of 9%. The previous requirement was 8%, with preliminary classification of assets and equity. To prevent from bad impacts caused by subsidiaries, SBV also imposed the consolidated CAR requirement for CBs.

B. Credit limit

Credit extension is the traditional business activity that creates main profits to commercial banks. Since CBs lend to customers with funds mobilized from the economy, the first important principle for this activity is the mobilized funds including principal and interest must be paid back. Banks return deposits and interest to depositors using funds paid back by borrowers. If the borrowers fail to pay back their debt, banks will get into trouble. Therefore, credit activity supervision is one of the main functions of the banking supervisory agency, or SBV in Vietnam.

Among important causes of NPLs is the connected lending. Lending decisions are based on the relations between borrowers and lenders, rather than the feasibility of the projects that would use the loans. When risks occur, the end losers are depositors and shareholders.

In addition, in many cases, in spite of a lot of efforts, borrowers default on their debt due to business losses incurred from objective causes. This leads to significant risks to banks because they are always obliged to pay back principal and interest in time to depositors.

Current regulations require that CBs should well define who is an affiliated customer and who are groups of affiliated customers, those to whom credit extension is limited or not allowed, and cases in which unsecured credit or preferential lending is not allowed. In particular, total loan balance to a

141 Decree 141, op. cit.
142 Circular 13.
143 Decision 457/2005/QĐ-NHNN.
144 Circular 13, op.cit.
145 Law on FIs 2010, Article 4, Section 28; Articles 126, 127, 128, and 129.
particular customer must not exceed 15% of the bank equity, and maximum loan balance to a group of affiliated customers must be 25% of the bank equity. Corporate bond investments are also counted as credit balance. A commercial bank is not allowed to extend credit to a firm operating in securities business of which the bank takes control.

C. Limit on equity investment and contribution

Equity investment/contribution is an activity of investment banks, rather than a core business of commercial banks. To prevent problems arising from the agency cost of equity, the current supervisory framework requires that CBs should set up or take over a subsidiary to carry out investment banking activities, financial lease, and insurance.\textsuperscript{146} Also, Law on FIs\textsuperscript{147} specifies the maximum capital contribution to each firm and the total capital contributed and equity purchased by a CB.\textsuperscript{148} CBs are not allowed to contribute capital and purchase shares in other CBs which are their shareholders or capital contributors. These equity investments and contributions must be taken out of equity when CARs are calculated.

D. Ensuring solvency

CBs mobilize deposits to make loans. Due to mismatching between deposit and loan terms, deposit terms are usually less than loan terms, CBs always assume liquidity risk. They maintain liquidity to secure deposits to depositors. Hence, SBV requires CBs should ensure their solvency.\textsuperscript{149} The ratio of quick assets to next-day liabilities must be at least 15%. The ratio of total assets due in 7 days to liabilities due in 7 days must be at least 1.\textsuperscript{150}

In addition, SBV specifies the maximum short-term capital to medium loan ratio of 30%.\textsuperscript{151} Also since 2010, Circular 13 had provided for the maximum loan to deposit ratio of 80%, but this provision was abolished in Circular 22 imposed later.

E. Loan classification and risk provision

When business activities face difficulties, risk provision and equity are the banks’ financial shields. CBs are required to, at least once a quarter, classify loans and make risk provision to the end of the last day of last month/quarter. According to current regulations, loans of categories 3, 4, and 5 are NPLs of CBs (see details in Appendix 3).

SBV sets forth requirements and keeps track of the loan classification and risk provision to ensure that CBs will not make capital losses. And yet, bad debt provision increases costs, and hence, reduces bank profits. Depositors are better protected because if a bank has high NPLs, it cannot pay dividends. Besides the five requirements as above, safe banking regulations also have other requirements including restrictions on real estate business.

\textsuperscript{146} Law on FIs of 2010, Article 103.
\textsuperscript{147} Law on FIs of 2010.
\textsuperscript{148} Circular 13, Article 16 and Law on FIs of 2010, Article 130, op. cit.
\textsuperscript{149} Law on FIs of 2010, Article 130.
\textsuperscript{150} Circular 13, op. cit.
\textsuperscript{151} Circular 15/2009/TT – NHNN.
The SBV’s supervisory framework is issued and continuously updated to better supervise the CBs’ operations. Many monitoring criteria approach the ones recommended by Basel Accord. Theoretically, with the current development level, if CBs comply well with existing regulations, the banking system security will be ensured. However, CBs have to take costs to comply with the monitoring framework and they may have incentives to create schemes to evade compliance. Cross ownership is one of them.

F. Requirement on internal control

Besides external supervision by the government agencies like BSIA and National Financial Supervisory Commission (NFSC), current regulations require that banks set up internal audit and control to help the leaders to manage throughout, safely, and legally all banking operations. Building and maintaining internal audit and control aims at preventing, finding, and dealing in time with risks possibly incurring and helps banks operate safely, efficiently, and legally, creating and maintaining values to shareholders, depositors, and other stakeholders.

Internal control system is a set of internal mechanisms, policies, processes, regulations, and organizational structures that is developed to prevent, finding, and dealing in time with risks and meeting the assigned requirements. Internal control system is an integral part of the daily banking activities. It should be designed, installed, and administered in all operational processes in all subunits to identify, measure, and assess frequently and continuously, and hence, finding out, preventing, and dealing properly with risks.152

Meanwhile, internal audit is to review and evaluate independently and objectively the internal control; assess independently the appropriateness of and compliance with internal regulations, policies, procedures, processes established in the bank; make recommendations to enhance efficiency of systems, processes, regulations; contribute to safe, efficient, legal banking activities.153 In this sense, internal audit aims at the banking safety and efficiency. Functions of internal audit are associated with the operating process and efficiency of internal control system. Internal banking audit operates based on fundamental principles of audit – independence, objectivity, and professionalism.

Due to the nature of the work, those who work in internal control and audit are required to have good conduct, honesty, a sense of compliance, and other necessary professional competency. The code of conduct for internal auditors also includes integrity, objectivity, confidentiality, responsibility, and cautiousness. Even legal requirements, however, are hardly eliminate or prevent from difficulties arising from the agency problem. It is because they may have objectives and motivations fundamentally different from those of ethical requirements, unless the bank’s incentive system is properly designed. Yet, this incentive system is created by bankers and implemented by managers. In turn, inherent risks of the agency problem between shareholders and bank manager occur as shown in Section 2.1.

152 Circular 44/2011/TT-NHNN dated 29/12/2011 on internal control and audit in FIs and foreign bank branches.
153 Circular 44, op. cit.
Appendix 5. Forms of cross ownership

Simple Form

A ←→ B

Linear Form

C ←→ A ←→ B ←→ D

Radioactive Form

B

A

C

D

Network Form

A ←→ B

C ←→ D

Circular Form

A ←→ B

C ←→ D

Modified Radioactive Form

B

A

C ←→ D
Appendix 6. Overlapping ownership matrix in Vietnamese banking system

Note: Shareholding information is as of 30 June 2011. Shareholdings by individuals are not depicted in the diagram. Shareholdings by institutions of less than 5 percent are not depicted except for those having representation in boards of directors or strategic partner status. Mekong Housing Bank and five joint-stock banks are not included in the diagram.

2. Shareholding by a group of related companies including Sovranet, Thal Thanh Cong, Bao Bien Toy Nut, Minh Thanh Group.
3. Indirect shareholding through Agribank Securities Company (Agmart).
4. Indirect shareholding through Vinasiam Securities Company (VINSEC).
5. Indirect shareholding through HCMC Securities Company (HCMC).
6. Indirect shareholding through HCMC.
7. Indirect shareholding through Investex Bank.
8. Indirect shareholding through CHIB.
9. Indirect shareholding through Tien Phong Securities.
10. Indirect shareholding through Bao Viet Securities.
11. Indirect shareholding through VNC Securities.
12. Indirect shareholding through HCMC Securities Company (HCMC).

Source: Recited from VELP 2012.

Appendix 7. Differences between market-based and banking-based financial system

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## Cross Ownership of Financial Institutions and Corporations in Vietnam

<table>
<thead>
<tr>
<th></th>
<th>Market-based</th>
<th>Banking-based</th>
<th>Banking-based</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Arm’s length (The U.S., U.K.)</td>
<td>Hausbank (Germany)</td>
<td>Main Bank (Japan)</td>
</tr>
<tr>
<td>Market capitalization to GDP</td>
<td>High</td>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td>Bank loan balance to GDP</td>
<td>Low</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Market capitalization held by families (directly and indirectly)</td>
<td>High</td>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td>Market capitalization held by banks (directly and indirectly)</td>
<td>Not allowed*</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Bank loan balance to corporate finance</td>
<td>Low</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Market oversight over firms (hostile takeover)</td>
<td>No limit</td>
<td>Partly limited</td>
<td>Limited</td>
</tr>
<tr>
<td>Information to shareholders</td>
<td>High</td>
<td>Limited</td>
<td>Low</td>
</tr>
<tr>
<td>Corporate control</td>
<td>Strong</td>
<td>Less active</td>
<td>Less active</td>
</tr>
<tr>
<td>Internal / Board of Executives</td>
<td>Members mainly from outside with strong influence on CEO</td>
<td>Two-tier BOM: Vorstand Aufsichtsrat</td>
<td>Inside</td>
</tr>
<tr>
<td>Voting right</td>
<td>Concentrated via investment funds and strong voting authorization</td>
<td>Banks vote on their own and on behalf of depositors (proxy vote)</td>
<td>Voting based on one’s own shareholding</td>
</tr>
</tbody>
</table>

* According to EU regulations, a bank based in U.K. can invest in non-financial companies and not need to follow the U.K. regulations; In the U.S., Gramm-Leach-Bliley Act of 1999 allows banks invest in commercial firms with limits broader than in EU.